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LECTURES IN CURRENT ECONOMIC PROBLEMS

A SERIES OF LECTURES WHICH WERE GIVEN IN THE U. S. DEPARTMENT OF AGRICULTURE GRADUATE SCHOOL IN COOPERATION WITH THE GRADUATE SCHOOL OF AMERICAN UNIVERSITY DURING 1935-36

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 LECTURES IN

CURRENT ECONOMIC PROBLEMS

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TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

GRADUATE SCHOOL
U. S. DEPARTMENT OF AGRICULTURE

The series of Lectures included in this volume was planned by the Economics Committee of the Council of the Graduate School of the United States Department of Agriculture.

The purpose of the Lectures was to stimulate interest in contemporary economic problems.

Two series of Lectures were held. The first series, comprising twelve lectures was designed to present Fundamental Economic Concepts and Principles. The second series of fifteen lectures covered the relation of Government to Economic Life. At the time this publication was printed twenty-two lectures had been edited by the speakers for publication. Two or three additional lectures may be received. If they are, they will be mimeographed and sent to purchasers of this volume without additional cost. Each lecture was followed by a discussion period. It has not been possible, however, to print all of the discussions. In some instances the discussion was not returned by the speaker, or the stenographers failed to take it down.

In connection with the second series of lectures, a seminar for more extended discussion was conducted by Mr. Robert B. Schwenger, Associate Agricultural Economist, with the cooperation of Dean Ernest S. Griffith of the Graduate School of American University. The course was planned and conducted with the cooperation of the School of Public Affairs and the Graduate School of American University.

Dr. Charles F. Sarle, Principal Economist, Bureau of Agricultural Economics, was Chairman of the first series and Assistant Secretary of Agriculture, Dr. M. L. Wilson, was Chairman of the second series. Business details, organization, and publicity was handled by Mr. Archie C. Edwards, Chairman of the Arrangements Committee, of the Graduate School.

A. F. Woods
Director, Graduate School

IS THE SELF-ADJUSTING ECONOMY WORKABLE IN CURRENT INTERNATIONAL RELATIONS?

By
Alvin H. Hanson
University of Minnesota

I suspect that to some, or perhaps most, of my audience, the term "self-adjusting economy" smells a bit musty. It will probably connote, to many, a concept not far removed from the familiar one which comes to mind when one sees or hears the words "laissez-faire". Yet, in point of fact, a self-adjusting economy is not synonymous with a laissez-faire system. A workable self-adjusting economy, indeed, requires a very large measure of social control.

It is a significant fact that Ricardo, working out his theories of long-term equilibrium in his Principles of Political Economy argues on the supposition that the value of money had remained constant. Now the value of money is not likely to remain stable for long in the modern world without a system of monetary control far more completely developed and far more thorough-going then any we have thus far achieved. Yet a workable self-adjusting economy, presupposes, as the equilibrium analysis clearly implied, a regulated monetary system. As we shall see later, however, what is wanted is an international, and not an isolationist and nationalistic, stabilization of the flow of purchasing power.

The essential characteristic of a self-adjusting economy is a system of control over economic life functioning through the free price mechanism. It is this that distinguishes it from the authoritarian economy in which consumption and production are governed by rationing and regimentation. Now it is of utmost importance to note that the tendency in current life to destroy the price system as a mechanism for economic control should not be identified or confused with the movements involving the rights of private property and the distribution of income. For it must be recognized that a price system can guide and regulate the economic processes of consumption and production in a socialist society as well as in a private capitalist society. To be sure the conditions under which it functions as a mechanism of control are not identical in the two cases. Under a socialist society the price system can, as in a capitalist society, guide and direct the channels of production along the lines indicated by the choices of consumers in a free market. In such a society, however, systematic cost calculations and group competition must of necessity supercede the more automatic adjustments of supply and cost which take place in a private competitive society. Yet these cost calculations must flow from the free-price system in the consumers' markets. Thus even under socialism it is quite possible to achieve a correct pricing of the agents of production.

It is often charged that price economists are social conservatives with a capitalistic bias. Whether, as social philosophers, this is or is not a fact, it will at any rate be admitted that as pure price economists their function is to analyze the interrelations of the price system regardless of what property relations may exist or in what manner the national income is distributed. For the price system can function with or without private property and with unequal or equalitarian income distribution. The pure theorist must take account of

these conditions, but whatever the conditions, his central problem is the functioning of the price system, the long-run tendencies toward equilibrium, the impact of changes upon equilibrium, whether these changes emanate from natural or human sources, and the cumulative disturbances which dynamic factors cause in a given institutional environment. These problems confront the price economist whether in a capitalistic or in a socialistic society.

It is, however, quite possible to conceive an economic order with a system of controlled individual prices - best described by the German phrase: "die gebundene Wirtschaft". Such an authoritarian or price-regulated society may be based either on private property or on the communistic ownership of property. An authoritarian or price-controlled economy is the precise opposite of a self-adjusting or free-price economy. Production and consumption are fixed by fiat, by direct intervention, by rationing and regimentation such as one observes on a wide scale in Germany, Italy and Russia today, and, indeed, in large areas of our own economic life. In such an economy the self-regulating mechanism of the flexible price system is ousted from control, and prices are dictated by private-monopoly or by political power. Every major depression has the effect of pushing us farther and farther into that kind of society.

The self-regulating economy of the free-price system has certain enormous values not present in the controlled or authoritarian price system. It offers to consumers freedom of choice in the satisfaction of wants within the limits of any given income. It, therefore, responds readily to new ideas, to the introduction of new products, and it guides production accordingly. It ensures a consumers' democracy though it offers no assurance of a democracy of producers. As a consumers' democracy, however, it affords a high degree of flexibility and of adjustment to change. As a system of economic control it rides rough shod over conservative production techniques and is insensitive to appeals for the permanent preservation of established skills and obsolescent equipment. It promotes and facilitates progress. This implies of necessity that on the debit side of the ledger must be set down a tendency, unless wisely counteracted, to promote insecurity and instability.

Large inroads have been made in the last two decades upon the free price system both in the domestic and in the international spheres. Russian communism, Italian fascism and German National Socialism have each gone far to institute authoritarian control and to supercede the price system. Even in more democratic countries the price mechanism has been subjected to interferences on a sufficient scale so that it is possible seriously to question whether it can continue to survive. Organized groups serving special interests have been interfering increasingly with the functioning of the price system. This, indeed, is nothing new. In America we have a long history of the ruthless methods of frontier buccaneers struggling for preferential position, for favors, for privileged charters, not infrequently by methods involving graft and corruption. Grabbing all one could in an almost boundless frontier with a superabundance of natural resources had, however, no serious consequences so far as the general functioning of the price system was concerned. What is new is not the purpose or motive of the special interest group, but the manner in which the booty is gotten. The modern buccaneer achieves his ends by manipulating and deranging the price system,

by securing prohibitive tariffs, by rigging the speculative market, by milking subsidiary companies through the device of the holding company, by fixing monopoly or quasi-monopoly prices through pools, cartels and trusts, and sometimes through an anti-social use of price association, trade associations, code authorities and trade unions. It does not require great knowledge of the decade of the nineteen-twenties to recognize that something of this sort was a leading characteristic of that period. This whole development in our corporate and economic life was dignified and defended under the alluring title of "stabilization". And it is gravely to be feared that the N.R.A. and its aftermath has enormously strengthened this tendency.

Through these modern devices, free market valuation and the flexible functioning of the price system have been seriously interfered with. A cost rigidity has been creeping upon the economic organism like a deadly arterial sclerosis, a hardening of the arteries of trade and commerce, an ossification, an aging, as Sombart puts it, of the economic organism. Modern institutional controls have narrowed the scope of free incomes and widened the field for fixed contractual incomes. Fixed charges, interest on bonded indebtedness, taxes, railroad and public utility rates, cost rigidity in the basic constructional and heavy industries, have come to occupy a larger and larger place in economic life. At the same time a hopelessly inadequate monetary and fiscal finance policy has prevented any reasonable stabilization of the flow of purchasing power. With a large part of the income on a fixed or contractual basis, fluctuations in the flow of purchasing power have caused violent profit inflations and deflations and the inevitable instability incident thereto.

At the same time serious interferences with the functioning of the price system have developed in international relations. Strenuous nationalistic efforts have been made and are being made to make the price system a closed one operating within the confines of one single country, out of touch with the outside world. In consequence of the breakdown of a system of fixed foreign exchange rates and an international currency, we have reached a condition in which there no longer exists any such thing as a world price system. Authoritarian control has in great part superseded the price regulating mechanism. Quantitative controls, quota limitations upon import, governmental monopoly fees and import control boards, exchange regulations and compensation agreements have made foreign trade a haphazard and uncertain thing, regulated and guided not by the valuations of a free market but by the arbitrary and shifting decisions of governmental officials.

The basic causes of the general collapse of the world price structure are well known and need not here be recounted. It is, however, necessary for our purpose to state the grave difficulties which confront us in restoring the world price structure and making it workable. In considering this problem certain fundamental characteristics of the modern world economy must be taken into account.

To begin with, under modern international conditions it is extraordinarily difficult to make the world price system workable in view of the unequal industrial development of different countries. A large number of countries are still preponderantly agricultural or raw material producers. Other countries of the world have reached a mature industrial development. The commodity price trends of the first set of countries are affected by special supply and demand forces operating in the raw material field. The commodity price trends of the highly industrialized countries are affected in large part by quite different factors. It follows that the commodity price level of agrarian countries may be falling, while that of industrial countries may be rising. Such a cross current of prices may put a severe pressure on the agrarian countries. With import prices rising while the prices of their export commodities are falling, a wide gap may develop in their international payments. Severe

pressure will then be exerted upon the foreign exchange value of the currencies of the agrarian countries. Gold outflows may force higher discount rates and this in turn a process of deflation to which the only alternative is the depreciation of the currency or a resort to strict authoritarian controls of commodity imports and capital outflows. Thus the unequal rates of industrial development in different parts of the world render difficult the smooth and efficient operation of the self-regulating international price system. These differential stages of industrial evolution have all through the nineteenth century created difficulties, but it has become seriously threatening only in the last decade or two, owing to the complication and re-enforcement of other disrupting forces.

Of graver import as a threat to the workability of the international price system is the wide differential between countries in the development of institutional controls of wage rates and other basic costs of production. Broadly speaking throughout the nineteenth century we could assume that the wage rates in each particular country would quickly become adjusted to the level of labor productivity in each industry in conformity with the principle of comparative cost. Unfortunately in considerable areas of economic life we can no longer count upon the attainment of any swift equilibrium of costs and prices in the international price structure. With rigorous institutional controls in the older industrial countries, and with little or no controls in those countries just in process of emerging from a handicraft to a mechanized society, profound international disturbances are bound to occur. England, with her powerful trade unions, and other institutional arrangements, partly of a governmental and partly of a corporate character, simply cannot adjust the costs of her textile industry to the Japanese price competition. Japan is not confronted with an aggressive labor movement pressing to close the margin between costs and prices and to raise the level of wage rates to the productivity of labor in the textile industry. She enjoys the competitive advantage of social customs and traditions which permit the continuation of a standard of living, not necessarily low, but cheap in terms of money cost. This facilitates the persistence of low money wages even in a thoroughly modernized textile industry where labor productivity is enormously higher than the general level of productivity in Japanese industry and agriculture as a whole. Thus the highly mechanized and efficient industries can obtain labor at money wages based on the low productivity level of the backward industries. This situation cannot fail to result in cutthroat international competition which either endangers the high labor standards of the advanced countries or else renders the employment of their labor precarious.

Owing to the failure of the international price structure to make the appropriate adjustment, the older industrial nations are driven to seek various forms of shelter. A mere increase in tariff rates may prove quite ineffective. Authoritarian methods of control are urged as substitutes for the price mechanism. The temptation arises to impose import quotas, thereby freezing the flow of trade according to a past mould. Or an effort may be made to conclude an international cartel under which there would be assigned definite market areas or export quotas to each country.

Thus the self-adjusting economy is thrown out of gear in consequence of maladjustment growing out of the continued internationalization of modern technology and the lag in the development of institutional controls. The strains could be minimized and tempered through voluntary arrangements such as the recent agreement

between Japan and the United States with respect to the trade with the Philippine Islands, without making a complete surrender to rigorous authoritarian controls. These strains and conflicts are, however, not likely to cease until the spread of industrialism has run its course, until the whole world has been brought under the sway of the modern machine technique, and until cost advantages and differential wage standards have been largely removed by the equalizing effects of capital, trade and population movements.

We have seen how the international price structure is being interfered with by reason of the unequal rates of progress in the industrial evolution of the various countries, by reason of the differential rates of progress in industrial technique and the unequal development of institutional controls resulting in cost rigidities in some countries and flexible costs in others. Thus modern international relations are profoundly complicated and disturbed by the unequal age of different parts of the world in terms of industry, technique and institutional controls.

The difficulties presented by these unequal rates of progress in economic evolution are, moreover, enormously enhanced in consequence of a recently developed characteristic of economic nationalism. I refer to the growing tendency of each country to manage the internal value of its currency. It is indeed a strange irony of fate that the effort to achieve stabilization of the general price level has itself become a factor in the general breakdown of the world price structure.

It was the earnest endeavor of the various international monetary conferences, beginning with the one at Brussels in 1920 and Genoa in 1922, to reconstruct and maintain the world price level on a gold basis about 40 to 50 percent above prewar. This attempt, we now know, miserably failed. It failed in part because the monetary structure which supported this price level was artificial, and in part, paradoxical as it may seem, because of the efforts put forth to secure stabilization of the price level.

The monetary structure, upon which the 1924-29 price level rested was insecure notably in two respects. In the first place, the newly established gold exchange standard was too delicate an institution to survive in the suspicious atmosphere of a highly nationalistic world. Secondly, the events of the war had left the fairly closely articulated international economic order with a wholly abnormal and not easily rectified maldistribution of gold. These two facts made the 1924-29 world price level a highly precarious one.

Confronted with this unstable international monetary structure, economists feared the danger of a general price collapse. A powerful movement developed, therefore, throughout the world to inaugurate and develop programs of monetary stabilization. Financial authorities in various parts of the world were urging the Federal Reserve Board, in particular, to lead the way in this matter. It was believed in many quarters that the very fact that an enormous proportion of the world's gold was concentrated in the United States, far from being an unfavorable factor, might become the basis upon which world price stabilization could be achieved. It was thought that this huge reserve of gold would enable the banking authorities to pursue policies liberated from the customary restraints which the gold standard had hitherto imposed. Now, at last, it was possible, so it was believed, to embark on a managed gold standard. The Federal Reserve System, unhampered by limited gold reserves, could, it was said, by open market operations and discount policies, control the American price level and thus indirectly control the price levels of all other countries operating on the gold standard. European economists, even more than those on this side of the Atlantic, relied upon the Federal Reserve System to maintain world-wide price stability.

The experience of the last few years, however, clearly demonstrates the

weakness of banking policies designed to maintain internal stability without regard to the requirements of international stability. Powerful forces - disturbances to international trade and abnormal international capital movements - were at work tending to unsettle the exchange and price relationships of the various countries. The strong post-war creditor position of the United States coupled with its high tariff barriers tended to attract gold to this country. A variety of factors operated to produce the same result in France. Those movements narrowed the base of credit in the rest of the world and served to put a downward pressure on world prices outside of these two leading creditor countries. Costs did not readily fall in England, Germany and other countries. Had their price and cost structures been sufficiently flexible, the strain on the foreign exchanges would have been eased off despite the stabilization of the American price level and the height of her tariff wall. But the fall in prices abroad in relation to the American price level was not sufficient to provide the flexibility needed to adjust the international balance of payments. England's position was progressively weakened by her inability to adjust her costs to the international situation and by the obstacles placed in the way of any reasonably free movement of world trade. Germany strenuously endeavored to meet the situation by her program of rationalization, only to find in many cases that she had been misled by technicians who had not taken adequate account of the weight of the fixed charges thereby incurred.

The lack of balance which developed was for sometime hidden from view by foreign lending. When at last this came to a necessary end, the accumulated tension, which had developed by reason of an inflexible international cost and price system, disrupted the foreign exchanges and brought about the world-wide collapse of the international gold standard. While many factors combined to produce this result, the point which I wish to stress, at the moment, is the contribution made to the disaster by the efforts at separatist price-level stabilization and the consequent failure of the various national price levels to reach an appropriate adjustment to each other.

The maladjustments growing out of this inflexibility in the international sphere were not unlike those encountered in a closed economy operating under a system of individual price maintenance or fixed price ratios for special commodities. Important changes in the <u>real</u> phenomena (such as technological developments, introduction of substitute products and major shifts in the relative significance of different industries, shifts in demand, differential rates of progress in cost reduction, and the like) call for a flexible adjustment to the new conditions. The maintenance of a rigid control of prices and costs accumulates strains and maladjustments that are likely sooner or later to find escape in a wholesale collapse of the general price structure. The successful operation of the price system in the domestic economy requires that we shall not fix once and for all in a frozen mould the price ratio of any one commodity or group of commodities. Any such attempt to straight-jacket the system of prices will in the end encounter the inexorable forces of technological progress. The price system cannot operate on this basis. If you apply price maintenance or fixed price ratios over only a part of the price field, the whole structure will ultimately break down. If you apply it over the whole field you have then substituted authoritarian rationing for the price system.

It is a seeming paradox that, in a dynamic order, stability of the

general commodity price level in a closed economy cannot be maintained without achieving first of all the flaxibility of individual prices. And similarly the stability of an international monetary standard cannot be safeguarded without permitting a divergence of the price levels of the various countries in accordance with the requirements of technological changes. The efforts of each nation to stabilize its own price level may lead to a general breakdown, thus defeating the separatist, nationalistic attempts at stabilization. Isolationist and nationalistic policies in the monetary sphere are as incompatible with the proper functioning of an international price system as are isolationist policies in trade relations.

The argument thus far leads to the conclusion that the post-war international gold standard might have offered better prospects of enduring success had it been permitted to function without the interferences interposed by the separate, nationalistic efforts at credit management and control. Yet it could scarcely have been expected that a wholehearted international monetary policy (involving the subordination of national credit policy to that of external stability) could be pursued at a time when isolationism and nationalism held sway in other spheres of economic life. Indeed, when one considers the economic sins committed in that decade the question may well be raised if it would not have been better had the international gold standard never been erected at all in the post-war period. The impossible international arrangements and conditions which emerged from the war might have done less damage had their baneful effects not been magnified by transmission through this highly sensitive international mechanism.

Similarly, it is a grave error to assume at the present moment that the apparently inextricable international tangle -- the trade barriers, the quantitative trade restrictions, the exchange controls, the gap between the out-payments and the in-payments of debtor countries, and the maldistribution of gold -- can be straightened out solely by re-establishing a system of fixed foreign exchange rates. The world price system continues to be seriously out of balance. The world economy is being tossed by gigantic speculative waves of capital movements first in one direction, then in another. Under the pressure of the currency disequilibrium the trend toward restrictive trade measures continues unabated. The depreciation of Sterling in 1931-1932 forced a panicky liquidation of securities and commodities in the United States and brought our banking, financial and business structure to the verge of bankruptcy. On the continent of Europe it started a wave of trade restrictions which has run its course through the whole gamut of new control devices including quotas, exchange control, payment and clearing agreements, barter and compensation arrangements, and preferential bargaining. England's abandonment of the gold standard, as is by now plainly evident, was a bomb loaded with enough dynamite to utterly shatter the international price and monetary structure. From this shock the world will not soon recover a new equilibrium. This shock in turn set off fresh explosions of which the chief was the depreciation of the dollar and the re-linking of it to gold at an undervalued rate.

With sterling cut loose from the gold anchor a large part of the world sought refuge from the storm by tying up their currencies to sterling. In this sheltered area London became the haven for safe keeping of a huge fund of liquid short-term capital drawn from all parts of the British Empire, and the countries attached to sterling. To this was added, particularly during the period of dollar depreciation in 1933, a large capital transfer from the United States.

The return of the latter country to a new gold parity in January 1934 was the signal for a sharp reversal in

these movements. The new dollar price of gold brought a return flow of a large part of the American funds that had temporarily been lodged abroad, and gave, moreover, a strong inducement to foreigners to repatriate the bonds held in this country. In addition, the revalued dollar increased both the value and the volume of our merchandize exports while at the same time it put a check on our imports and especially upon our tourist expenditures abroad. The combined affect of all this was a vast influx during 1934 of one and a quarter billion dollars of gold. This gold, however, was not drained from the central banks abroad but came from new gold production and from private hoards.

In the current year, 1935, our merchandize and service items are for the first time, since we became a creditor country, in substantial balance--an unhealthy balance, however, since it is based in part on a decline of our exports to Europe and in part on defaults on interest and debt payments owing to us from abroad. Despite this apparent balance, the pressure on sterling, which had begun in the spring of 1934, continued unabated and created a crisis in March 1935. At this time sterling touched the lowest point in the depression. This pressure on sterling was caused by the continued transfer of short-term funds to the United States, the continued repatriation of foreign bonds and the purchase by foreigners of American securities. The pressure on sterling was released following the March crisis, not in consequence of an improved international adjustment but only by reason of the increased strain placed upon the gold countries. In this connection it is of interest to note that the inflow of gold during the current year into the United States is almost exactly balanced by the loss of gold from the central banks of France, Holland and Switzerland, while new gold production has been substantially balanced by renewed gold hoarding.

The continued inflow of capital and gold into the United States is an index of the current unsettled state of international relations and of a lack of equilibrium in the cost-price structure. So long as the gold currencies remain considerably overvalued in relation to the dollar, so long as the threat of war lurks on the horizon, capital movements, both short-term and long-term with attendant gold shipments, will continue to flow to the United States. And so long as this inflow of capital and gold continues, trade restrictive measures will be clamped down tighter and tighter. Of one thing we can be certain; capital would not be flowing to the United States at the present moment, were all right with the world. If, and when, a new international equilibrium is finally reached we can be sure that the United States will again emerge as a net exporter of capital on a moderate scale. No surer index of a serious derangement in international economic relations could be found than the fact that this country is a large importer of capital. If, however, we attempted arbitrarily to stop this inflow, as some have urged, we should merely be treating the symptom and not the deep-seated underlying malady.

The current international situation is highly explosive. The various economies need to be tied together again by means of a system of exchange rates fixed at ratios which conform as nearly as can be determined to the cost levels in the different countries. Unless a bold effort is made in this direction soon we face a serious danger of saddling upon the world a straight jacket of authoritarian controls in foreign trade. France at the moment is considering the substitution of tariffs for quotas. This in itself would be an important step toward a larger functioning of

the price structure in international relations. Stabilization would surely facilitate this development. But the longer it is delayed the more powerful will inevitably become the vested interests which profit from the existing quantitative controls.

Moreover unless the leading countries are linked together soon by an international currency, whether by formal agreement or on a de facto basis, the future may drive the various economies even further apart than they are today so far as costs and price levels are concerned. This possibility, or even probability, springs from the widely divergent domestic credit and governmental finance policies pursued in the various countries, as well as from the widely different outlook for profit making. The various countries are emerging from the depression at quite uneven recovery rates. And the limits of possible divergence are enormously great by reason of the great inequality in the holdings of gold reserves. Moreover, once these divergent tendencies become considerable, they feed upon themselves and grow in cumulative fashion. Suppose, for example, that a powerful credit expansion should develop in the United States encouraged and supported by a strong expansion in the capital and durable goods industries. Such a development might easily cause a tremendous speculative boom which would draw capital and gold in large volume from other countries to the United States, thereby placing a check upon their internal expansion and re-enforcing our own. Such an unequal expansion in different countries could not fail to place a renewed strain upon the international system, and thereby force a continuation or even intensification of the authoritarian restrictions and controls of foreign trade.

International stabilization is therefore urgent not only as a means of promoting an approach toward a new equilibrium but also as a means of holding the expansionist movements in the various countries in line so as to prevent the accumulation of renewed strains and tensions.

This consideration emphasizes the all important fact that a new return to fixed exchange rates will not of itself suffice. Such a system cannot under modern conditions automatically make the necessary adjustments for survival. Experience shows that it will not do merely to reconstruct an international currency and then pursue thereafter an international laissez-faire policy. Leading countries must be able and willing to practice close cooperation in a deliberate international management of that system.

Unfortunately the maintenance of international equilibrium is rendered difficult not only because of unequal progress in different parts of the world in technological development, to which reference has been made, but also by reason of unequal rates of progress in the development of monetary theory and monetary technique. It is a matter of no little significance from the standpoint of international equilibrium in the years which lie just ahead that England and France stand almost at opposite poles in the matter of monetary theory and banking policy. So long as the responsible financial leadership of these two leading European countries adhere to such divergent views as to what constitutes appropriate banking policy in the various phases of the business cycle the future is not bright for the workability of an international price structure and the maintenance of international equilibrium. Add to this the fact that in the United States opinion is sharply divided so that no consistent course of action can be relied upon in successive administrations or even in the same administration. This lack of agreement on monetary issues presents a dark outlook for the future. It would be

difficult to think of any field for serious economic research so urgent and pressing, so likely to bring incalculable benefits, as that of appropriate cooperative international action on monetary and public finance policy. Widely divergent programs of governmental capital expenditures and of monetary policy are likely to throw incomes and price levels in the different countries dangerously out of line and place a severe strain on international equilibrium.

The rationale of coordinated international action is clearly evident when we contemplate the manner in which the world is now muddling its way through to a new monetary system. It was not necessary in order to reach the required reforms in the world's monetary structure to take the thorny road we have trod since 1929. Instead of separatist devaluations of one country after another with the attendant deflationary consequences in the countries with over-valued currencies, and the quotas and exchange controls incident thereto, what was needed in the world crisis was simultaneous international agreement on changes in reserve ratios, or simultaneous changes in the gold content of the different currencies, as had indeed been suggested in various international financial conferences. Unfortunately the history of the post-war period shows that the world has not reached that level of enlightenment by which it can yet reach a rational solution of its problems by taking action prior to the advent of diaster. We do the things that reason and scientific knowledge tell us we should do only after we are goaded into action through the pressure of catastrophic distress and intolerable human suffering.

It is an open question whether we can achieve a sufficiently high level of public intelligence and understanding of the necessary conditions required to make the price system function. This is true of the internal domestic sphere as well as of the international sphere of action. In the modern complicated and highly sensitive economic order it may, indeed, require a higher order of intelligence and understanding to operate successfully a free price system than is required to operate an authoritarian society. But those countries which succeed in operating the price mechanism can be expected to out-strip all others. It is not altogether an accident that modern Sweden is both a foremost practitioner of a liberal economic philosophy and at the same time in the vanguard of modern nations in the achievement of a high real income for her general population -- a standard reached without sacrifice of personal liberties and freedom of the individual. It takes brains, character and leadership to operate a liberal price economy in the modern world.

The issue of authoritarian price control versus a flexible price system is a major economic issue if, indeed, not the major economic issue of modern times. It cuts deeper than those issues which run in terms of changes in the distribution of the national income, for a flexible price system would of itself result in a more equal distribution of income. It is more fundamental than those issues which run in terms of the organization of production whether on capitalistic or socialistic lines, for it is concerned with those ultimate problems of maximum consumer satisfactions and the best allocation of the productive resources of society, which no form of social order can afford to ignore. On the domestic field the issue arises in terms of the struggle of different groups to fix prices on individual commodities or to freeze specific commodity price ratios at some given parity, thereby seeking to shelter themselves from the impact of a dynamic economic world and to prevent

the gains of technological progress from flowing to society as a whole. On the international field the issue arises from the effort of the separate national economies to isolate themselves from the world price structure by means of under-valued currencies, prohibitive tariffs, government monopoly controls, quotas and exchange controls. Special interest groups are, indeed, busily at work digging the grave of the free-price system but with spades wholly different from those predicted by Karl Marx.

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DISCUSSION

Question - Dr. Fox, Tariff Commission- I wish to put a question or two in the field of foreign trade. Do the present efforts of the United States Government toward removal of trade barriers raise some hope for the future, in two respects: In making it possible for various countries to remove - to lower at least - the trade barriers grown up in recent years; and in creating an atmosphere in which stabilization may be more easily possible?

Answer - I think Dr. Fox's closing phrase suggested what to my mind is the correct answer. I myself have always looked upon the trade agreements program as of far greater significance in its general impact upon world society than as a specific means of directly and immediately enlarging the flow of trade. To be sure, these trade agreements do have the effect of lowering some of our tariffs and of enlarging other countries' quotas, but I think there is a larger influence of our trade agreements program. In the first place, it is the only mechanism which I can see at all, by which this country can grapple with the world tangle. Suppose we had no trade agreements act; as I see it, there would be no way in which this country could at all tackle the problem. It can through the trade agreements act nibble away at the trade barriers throughout the world and thereby prepare the way for conditions that are more favorable for stabilization. We cannot look for any large expansion of world trade stabilization. We cannot look for any large expansion of world trade merely through trade agreements, but the trade agreements may turn out to be, nevertheless, one of the most important things taking place in the world today. They are preparing the way for stabilization and thereby in large measure affecting world trade.

Question - Dr. Stine, Bureau of Agricultural Economics - Several questions come to my mind, but I will simply ask one. Would abandonment of the use of the stabilization fund, and any other measures now being used in regulating the value of the dollar in foreign exchange, be a real contribution toward international stabilization?

Answer - So long as the stabilization fund will permit gold to flow out of the country, we are really on an automatic gold standard. In other words, we are not relying upon the stabilization fund to stabilize the gold value of the dollar in foreign exchange. We are really on a gold standard so long as we permit the free outflow of gold. There was one time in the last 12 months when there was a small outflow of gold.

In a larger way I think that our stabilization fund undoubtedly has been used to help steady the exchange of other countries. It became known last spring through the press that the Secretary of the Treasury has used funds from this source to assist the French following their March crisis, and they expressed great appreciation of the cooperation. This probably is an indication of what is taking place - an increased measure of international cooperation

to facilitate something like a de facto stabilization. It may be that a considerable period of international cooperation - through stabilization funds and central banks - in achieving a de facto stabilization, may be a necessary preliminary to a legal stabilization of currencies.

Question - Dr. Edminster, Agricultural Adjustment Administration - Dr. Hansen referred to the spread of industrialization throughout the world and the need for a greater evenness in the state of advancement of industrial technique. In that connection I would like to ask him - in view of the stress that a great many economists, Keynes, for instance, have laid upon the significance of declining differences in the state of advancement of industrial technique from the standpoint of international trade - what do you think are the implications of that world-wide spread of industrialism from the standpoint of the quantity and type of future international trade, particularly the foreign trade of the United States?

Answer - There are involved here two questions - one a question of the transition period, the period while the newer countries are becoming industrialized; and the second, what will be the case after they have become industrialized, from the standpoint of international stability? I was emphasizing the impact of the transition period upon international stability, the dangers that tend to develop while these countries are in process of becoming industrialized - the impact upon international competition; and another question - the effect upon volume of trade. I think that while the process is going on, it inevitably of itself gives rise to a large volume of trade because, while the backward countries are in process of industrialization, they of necessity must import large quantities of capital goods in order to become industrialized. There is the well-known phenomenon that the leading European countries have had expanding exports of capital goods, much more than of consumer goods. That fact is related to the increasing industrialization of backward countries. While the process is going on, it gives rise to a vast amount of foreign trade. Countries cannot industrialize without having large imports from the older countries of capital equipment. Then there arises the question: After industrialization, what may become of foreign trade? It is an interesting fact that as Germany became industrialized, her trade with England did not diminish but grew. That may or may not mean something as to the future trade of the world after backward countries have become industrialized.

Those of us working on trade agreements have been very much impressed with the extent to which industrial countries specialize. Industrial countries do specialize in the modern world, and that in itself would tend to develop trade even after they had become industrialized. Then there is another fact - the more those countries become industrialized, the higher their income will be. They may buy a smaller proportion of certain goods from a country, but it does not necessarily follow that there will be a smaller absolute volume. In terms of their total national income, they may import less than now, but the absolute volume might well increase nevertheless. I think, therefore, that because of the inevitable improvement in standard of living of countries, which will come with industrial progress, the prospect of a large volume of world trade in the future is by no means dark. If, however, it develops that the world price system utterly breaks down, I think it almost inevitably will follow,

because of nationalistic sentiment, that countries will strive to import as little as they possibly can. Bilateral bargaining would tend to develop between each pair of countries. Should that occur, my own view would be that foreign trade would be reduced to minimum proportions. If the price system survives, I would expect foreign trade to grow, even though we witness the increased industrialization of backward countries.

Question - Dr. Stine - It appears to me that the answer Professor Hansen has given to the question which is the subject of his address, is that the self-regulating economy is not workable in current international relations; but it appears to me that he argues that it should be workable. Would he undertake to make a more definite statement as to the ideal American policy that would result in what he would set up for a rational international system?

Answer - That is a rather large order. The difficulty with the ideal American policy is that it could not be put into operation without taking other countries into consideration. I would say that the workability of an international price system does involve in the first place an international monetary system. It cannot be made workable with the individual national currencies. There are people who dispute that, but I think they rely too much upon the wholly non-political manipulation and control of these various domestic currencies. If the several countries could pursue their policies in such a manner that they would not impose strains upon the outside world, if they could pursue a policy which kept their internal price relationships in balance with other countries, then such a price system might work. And it might turn out that the aid of internal stability might run counter to the other necessity of preserving world stability. We must get back to an international currency, fixed exchange rates, presumably a new international gold standard. That is the first thing.

The second thing is that we must not simply set it up, but the various countries must cooperate in making it workable. And cooperations mean that they will not go off at widely divergent tangents in monetary policy and in public expenditures. The most important reason why Germany is in the tight place she is, in her foreign trade right now, is in my judgment that fact that, while continuing to maintain her former gold parity, she went in for large capital expenditures. You cannot ride both horses. There is bound to develop a gap in the balance of payments and this forces the country into exchange control, and rigorous authoritarian control of imports.

Thirdly, the countries throughout the world must again give scope to the operation of the price system in international trade by the removal of exchange control, and of quantitative trade controls. Tariffs do not need to be removed and they do not even need to be lowered enormously to make it workable if the other things which I have mentioned are put into operation, because if those other things are done, not very serious strains will develop. But if unwise policies are pursued, then strains will develop, and if strains develop, then it is very important to have a large volume of trade to ease off those strains. Consequently, since we are not likely to get 100 percent cooperation on international management of currencies, it is all the more important to develop a large volume of foreign trade. If there is a great storm and a tremendous downpour, and there is just a narrow river bed the surrounding country will be inundated; but with a broad stream the rise will hardly be noticed.

Question - Audience - What is a free price system?

Answer - In the domestic field, price relationships of different commodities

will develop in accordance with the technological developments in different industries, so that as costs are lowered prices are lowered also. In a free price system, the different commodity prices in the internal price system, instead of being frozen, will be flexible. If you have price monopolies, cartels, or trade associations, the prices become frozen. If you have frozen prices and at the same time do not have sufficiently strong public finance control, a drastic decline in the whole income will result. The existence of those rigid prices creates a tremendous disequilibrium.

Question - Audience - How far has the loss of foreign trade accounted for our depression? If it accounts for it in a large degree, may we hope for recovery before we have recovered the foreign trade?

Answer - The total value of our export trade was about $5,000,000,000. Now when you come to figure up all of the major industries in this country that will be required to equal an output of $5,000,000,000 you will see the tremendous importance of our foreign trade. The decline of our foreign trade is, of course, largely a consequence of the depression. The depression was due to a variety of forces of which I regard the international disequilibrium and the policies pursued with respect to foreign trade as extremely important. The foreign trade decline is a result rather than a cause.

Sweden has a high standard of living. She is a leading example of a country that has already achieved a complete revival. Her production is at present normal, in fact on a level from 10 to 15 percent higher than in the boom years before the depression. Norway is on a level above predepression times. England's industrial production is now up to the predepression level. All of these countries except England have, however, more unemployment than before the depression, by reason of increased technological developments which have displaced labor despite the larger production. The unemployment is partly caused too by some increase in the working population. All over the world, I think - perhaps without exception - we are experiencing a revival in industry, but there is no revival worth talking about in the volume of foreign trade. It is just about the same as at the bottom of the depression. This goes to show that you can bring about a considerable revival in the world without foreign trade leading the way. But there remains a vast volume of unemployment and world production is still far below what is attainable. In order to achieve full prosperity a larger flow of world trade is necessary.

TRADE UNION ORGANIZATION AND LABOR'S BARGAINING POWER

By
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The problem of labor in modern society is one that impinges upon virtually every aspect of our life. I doubt whether there is a vital human and social interest that isn't affected, directly or indirectly, by the policies, activities, aims, and endeavors of the trade union movement.

Labor in the United States is not organized in the sense that workers in other countries are. Our situation is quite different from that of Australia, for example, where most of the workers are organized. We are quite different from Great Britain where most of the essential industries are organized. We are quite different from what Germany was before the change of government in 1933. There you had organization in virtually every important industry. In the United States, I think it is fair to say that, with the exception of a few industries such as building construction, coal mining, certain sections of the manufacturing industries, particularly men's and women's clothing, it is fair to say that industry is not organized in the sense that labor through its organized relationships has the power to control the conditions of employment.

Trade unionism, organized labor, through its daily activities, affects, as I said a minute ago, every vital social aspect of our lives. If we look down through the list of things that are affected by trade union organizations, you will find that every aspect of production is affected, through the determination of hours in which men can work; through determining whether people shall be permitted to work overtime; through having a hand in saying whether new machinery shall be introduced; in determining the speed at which men can work; determining who shall be hired and who shall be fired; by determining, through the closed shop regulations, who can work and can't work; through determination as to who shall be permitted to do the work, as happened in the case of a jurisdictional dispute we had when the Labor Department building was being put up. The question in that instance was who shall be permitted to put certain iron grill work over the radiators. The carpenters insisted it was their work, the metal workers insisted it was their work, the result being that neither did the work and the job was tied up for a period of time. Later, in determining who shall install certain types of tiling upon the floors there was a dispute as to whether it was under the jurisdiction of the cement workers, the plasterers, or some other trade. There, again, the unions decided who should do the work.

We in America like to think of ourselves as endowed with certain established rights, and trade unions impinge very largely upon those rights in their daily activities. They interfere with the employer's right to run his business as he sees fit, and labor insists that that right can be interfered with if the vital interest of employees is concerned. Trade unions do interfere knowingly and avowedly with the rights of business men to run their business. Through the closed shop they determine who shall work for a given employer and through wage standards they determine how much shall be paid by employers.

Labor organizations also impinge upon the distribution of income. Through their demands that wages become greater and greater as the profits of industry increase, they play a very important part in determining what portion of the income of industry shall go to profits and what shall go to wages, a condition which, in the absence of trade union organization, is for the most part within

the rights and powers of the employer.

Trade unions become of great importance when you are discussing combinations in restraint of trade. They play a very important part in that aspect of the law which provides that people can be enjoined by injunction from doing certain things, and time and again the injunction has been used in order to thwart the purpose of trade union organizations.

They affect our standards of ethics. A trade union man is expected to be loyal to his group rather than be a free individual. The idea of class, of craft loyalty, is a very significant factor in determining the effectiveness of labor organization, and the very situations under which labor organizations work demand that their members sacrifice their individualism and their ethical standards of individualism for class loyalty.

Trade unionism very definitely interferes with our ethical attitudes towards property rights. The philosophy of trade unionism insists that life comes before property and frequently a demand is made for increased wages in order that minimum standards of living be maintained at the cost of property.

There are trade unions in this country--they are fewer in number now than in the past--but I am thinking particularly of the Industrial Workers of the World, whose ethical standards were that might makes right. They believed in violating contracts if they had the power to do so and if by doing so they could increase the standard of the workers associated with them.

Trade unionism bears upon our ethical standards where issues arise as to whether or not physical violence should be used. Members of trade unions have used physical violence, employers have likewise used it, and who starts it is frequently an undetermined question. But there are trade unions that believe that they are ethically correct in insisting that, if the welfare of their members is at stake, if it is a question of their men starving or attaining their ends, there is justification in using physical violence. If they believe that physical violence is being employed through strike-breakers, detectives, or paid guards on the opposing side, physical violence is particularly justifiable.

Another ethical aspect of trade unionism is the use of ostracism. The average trade unionist believes in the right to ostracize people who will not coöperate in gaining the ends sought for the union membership. Consequently they use the word "scab", and in England the work "black-leg"--people who are socially outside the pale, as it were, in the eyes of the trade unionist. Such a person or group of persons interfere with the ends sought by organized labor, namely, increasing the standards of the group which they represent.

Trade unionism is also definitely related to social welfare. I need only cite to you the Adamson Act of 1916 where the transportation facilities of this country were threatened because of a possible general strike when labor demanded an eight-hour day. There was a threatened strike and a demand on the part of labor that Congress pass legislation making the eight-hour day mandatory, and there is no doubt but that President Wilson pushed that law through Congress because he did not want a strike as the national welfare would have been in danger. After the coal strike in 1919 had been in effect for a month, certain plants had to shut down because of lack of fuel.

If we are going to deal with the organized labor group which constitutes a very important segment of our society, if we are going to understand the various factors that affect you and me, we must understand why it is that labor does the things it does and why it is that labor demands the right to do them. We must bear in mind that trade unions are only one of many groups in our society. We frequently hear of so-called pressure groups. You've got your Agriculture group which is a very

definite pressure group interested primarily in the welfare of the farmer, and if you go back through the legislative records for the past two decades you will see the effects of that pressure group as it exerted its influence upon our government. You have Chambers of Commerce which is again a pressure group whose sole purpose is to bring about certain ends which fit in with the philosophy, with the attitudes, and the sense of justice of its membership. Likewise, labor is one of these many groups. Labor has its standards of justice and welfare in matters that concern it, and frequently it does things which to you and to me seem unjustified, as for example, a sympathetic strike, where a group of people refuse to work because another group are not in their own opinion receiving justice. Instances can be cited where men go on strike not because they have any objection to their employer or to conditions, but in sympathy with other workers. Under such conditions it is easy to understand the attitude of certain business men toward trade unionism.

Now, the attitude of labor toward the sympathetic strike, toward jurisdictional disputes which will tie up a building although the employer is not concerned, those things bother the employer. He cannot understand why those things should take place, and unless we understand what is behind them we come to the conclusion that labor is unfair in its demand, that labor is doing anti-social things.

If we are to understand trade unions we shall have to understand them in terms of the problems that affect their interests. Perhaps I can best illustrate what I mean by taking up the question, say, of efficiency of labor. There are a lot of things that labor does which on the surface appear to interfere with efficiency of output, and if we do not understand organized labor in terms of its own problems, we immediately come to the conclusion that many of its practices have as their end the limitation of the efficiency of output. If you take that concrete problem by itself you will find that in dealing with the question of efficiency of output, you have two definite problems involved. One problem involves the problem of wages. The other is that of employment. But let us deal with the problem of wages.

Now, what is it that determines wages? We talk about wages being determined by free competition on the labor market and a lot of people believe that this is the only way they should be determined. Yet what do we mean when we say that wages should be determined by the free competition of the market? We usually mean two things; first, the output of the worker which determines what you can pay him, and, second, the standard of living of the worker himself which determines in large part the supply of labor. The willingness to work at a given wage rate is for the most part nothing else but a function of his standard of living. He will not take less than is necessary to maintain his standard if he can possibly help it.

What happens to wages if there are no standards of output, if the employer can fix his own standard and change it any time he wants to? The tendency under such conditions is a lower wage. Unless you have an agreed-upon standard, what does determine it? Where you do not have collective bargaining or mutual agreement as to standards, experience has shown time and time again that the standard becomes that of the fastest worker. And if the fastest worker has high earnings, earnings which are more than sufficient to maintain the standard of living of the group he represents, experience has shown that wages will tend to be cut to the point where the faster workers will have earnings sufficient to meet their standards of living, which means that the other workers who cannot meet the output of the fastest workers are forced to a wage level below their standard of living.

When I say that the demand for a definite standard of output is an

important factor in organized labor's attitude in bargaining with employers. I mean that the experience of trade unions has proven that without definite standards high output by a few workers leads to less wages for everybody or more work for everybody with the same wages. That is a practical fact. Anyone who knows anything about the labor movement can cite endless cases where when fast workers get up to a certain high wage level, rates are cut so that they can earn only a fair wage, and everybody else who cannot maintain their pace receives less.

Of course, there are fast workers, there is no denying that. I received a report yesterday from a plant in one of the biggest industries in the country. That plant reported that there were seven people working on piece rates who averaged $200 a week during the week covered by the report. The manager of that plant said to me, "It's much more profitable being a laborer in our plant than being a Commissioner of Labor Statistics." People do earn $200 a week in that plant and it can be done for a week or for two weeks, but experience has proven that as word of it gets around to the management it too often happens that someone decides that there must be something wrong and wages are cut so that those who have been earning large amounts find their earnings down to half of what they formerly were receiving.

I cite this as one of the reasons why trade unions' demand that there shall be a standard of output should not be interpreted as opposition to efficiency, per se. One way of finding out whether labor is opposed to efficiency would be to offer to an organized group an increased wage in return for an increased output. That should be the test of whether or not labor is willing to increase output or increase efficiency.

Another reason for the general belief that trade unions are in principle opposed to increased efficiency, is the fact that they oppose piece rates. They do not like their members to work under the piece-rate system. Wherever possible they demand an hourly rate or a weekly rate. They do not oppose piece rates because they are opposed to the men producing more or because they are opposed to permitting increased efficiency. They are opposed to piece rates because through experience they have found that under the piece-rate system, there are always people who push themselves virtually to death. Such people have very high earnings. Experience, however, has proven time and again that with a given piece rate you can earn much more than is generally paid or received in your industry, and if that goes on for any length of time the next thing you know your piece rate is cut so that you have to turn out the same amount of work in order to earn a lower wage than you formerly did.

There are a great many other instances of this sort where one cannot say whether the attitudes of organized labor are right or wrong unless you know just what is behind them. There is the question of uniformity of wage rates which is frequently interpreted as a means for bringing everybody down to the same level of mediocrity. As a matter of fact, this insistence that everybody doing the same type of work shall be paid the same rate has nothing to do with trying to put all workers on the same plane of mediocrity. It is entirely the result of a situation where unless you do insist that everybody doing the same type of work get the same wage rate, somebody from the outside will under-bid those on the job. Experience has shown that the bargaining power of the group is always equal to the power of the weakest member of the group. Unless you can make all members equally powerful in their bargaining power, you find the situation where the man willing to work for the lowest rate will in the long run determine the rate to be paid.

The trade unions in this country have gone through a very interesting development. We have had all sorts of experiments with trade unionism. Most of our unions have developed in response to immediate needs and

problems, the immediate needs and problems of specific groups. They have grown and developed entirely by trial and error. As far as the people who are running those organizations are concerned, there has been no definite theory behind their activities. They have experimented.

There are records of small organizations here and there in various parts of New Jersey, New York and Massachusetts during the '30's of the last century. These trade unions played a very important part in the movement towards free education in America. As a matter of fact, they took the load and were responsible for the propaganda which led to the development of free education in this country. We have had all types of trade unions - Socialist trade unions whose main guide was the theoretical idea. We have had organizations like the Knights of Labor which at one time in the '80's was the organization in this country. Anybody could belong to it, irrespective of what he did. It was one big organization with no distinction between craftsor anything else.

The typical type in this country at the present time is the craft union. It limits its membership to persons who are engaged in specific crafts. Carpenters and plumbers admit only those doing that type of work, irrespective of the industry in which they happen to be working. You may be a carpenter in an apartment house, but as long as you are a carpenter and use his tools you come within the group admitted into the carpenter's union.

The second important group is the industrial union type. In this instance, membership is restricted to those who work in and about a specific industry, irrespective of what they do. The best example of that type of union is the United Mine Workers. As long as you work in or around the mine, you are eligible to membership in that organization.

The big problem facing American trade unionism today is whether or not we shall continue with our older system where individual crafts are banded together or with the system represented by the Mine Workers and The Brewing Workers, whereby membership in unions shall be determined not by what you do but by where you do it. That was the basis of the fight in the American Labor Convention a few weeks ago in Atlantic City. Shall the craft unions be permitted to maintain their craft distinctions or shall the automobile workers and the rubber workers be permitted to have their own unions? The fact is that workers in the automobile industry have organized. They have an automobile workers' union. It has not however been recognized as an independent international union. There are groups in the American Federation of Labor who refuse to permit these workers to have an industrial union of their own. The present controversy will determine how the future of American Labor organization shall be molded. The industrial union group is headed by John Lewis of the Miners, and supported by the Amalgamated Clothing Workers and other unions.

The reasons for and against industrial unionism are many. The main contention in their favor is that in large-scale industry it is impossible for any one small group, say the carpenters, to realize its aims when it constitutes a small portion in the industry. By and large, to secure effective bargaining power for labor in modern large-scale industry, you must bring a large proportion of the workers together and act as a unit, otherwise you cannot bring up their standards of living. And it is ability to raise living standards that is going to determine the attitude of those who don't belong to unions.

A majority has determined that the craft system shall for the present continue as it is. The A.F. of L. has refused to go on record as favoring industrial unions.

In addition to craft industrial unions, there are so-called "labor" unions in this country. The term, "labor unions", is peculiarly applied to a type of union which does not distinguish between crafts and does not distinguish between industries. In a sense it is the automatic outgrowth which has

followed from the fact that in certain cities of the country there are five, six, and more unions - locals of plumbers, carpenters, brewers, etc. Almost spontaneously these groups have come together to discuss their mutual problems, and there has developed over a period of time so-called local labor unions--sometimes called "trades" unions--the name signifying the fact that they are made up of a whole lot of trades. They are made up of anybody who happens to be a member of a union affiliated with the A.F. of L. and they are primarily interested in local problems. They are the units through which local sympathetic strikes are arranged.

The dominating factors in American organized labor are - first, the A.F. of L., and second, the so-called Railroad Brotherhoods. The latter are made up of the train service crews of the railroads - the engineers, the firemen - and the conductors and brakemen. They frequently and usually work together when it comes to making agreements with the employer, and in seeking legislation. But they are four independent units working together on problems of their industry. Their membership is independent of the A.F. of L. and number about 800,000. The A.F. of L., however, is a federation of trade unions just like the federal government is a federation of states. Each organization in the A.F. of L. has powers of its own. The A.F. of L. has 3,186,600 members, which means that the organizations affiliated have 3,186,600 members. The miners have 400,000 members.

The life of the federation dates back to 1881, although many people have placed it at 1891. It is a federation of 110 national or international unions. The term, "international", means that some of these unions have locals in Canada. The individual unions vary in size and in importance from organizations like the Mine Workers, a rather powerful organization with a powerful treasury, to relatively small unions. In addition to these 110 national and international unions which are both craft and industrial, there are 49 state federations affiliated directly with the A.F. of L. There are 728 city central unions or local trade unions. There are approximately 1007 federal unions and 4 departments. Each department and each state federation and each of the city central and federal unions have votes at the annual A.F. of L. conventions.

There was an interesting controversy recently between the brewers and the teamsters. The former maintained their union during prohibition and took on new and vital life when prohibition was repealed. They control the entire brewing industry. The question arose as to whether or not the drivers of the trucks belonging to the breweries should not belong to the teamsters' union and the executive council of the A.F. of L said yes. It caused a lot of bad feeling and some fights, and the problem has not been entirely settled. If you ever discuss the matter of jurisdiction with trade union members, you will find that they have a most remarkable memory and can always go back to a date beyond any you can remember.

The best illustration of the powers of the individual international is the discussion that took place at Atlantic City in regard to Communists. There was a movement on foot to make it illegal to have Communist members in any union. It was defeated on the ground that unions have the right to run their own organizations. It was held that it was not a function of the A.F. of L. to tell them who their membership should consist except as provided in their charters.

There are four departments in the A.F. of L. These grew out of the need for unification between the various crafts that were engaged in the same industries. I have mentioned the jurisdictional dispute at the Labor Department building - such jurisdictional disputes arise frequently. To cope with such disputes the A.F. of L. has created a building

trades department to which the various building crafts belong, on the theory that with their own organization and chairman these disputes could be settled within the family, as it were. There is also a metal trades department and a railway department with which are affiliated those who work in the metal trades and railroads. There is also a fourth department, the label department, whose function is to spread the use of the union label. The metal trades department just a little over a year ago acted for the first time as representative of the 13 unions which are affiliated with it, in making an agreement with Anaconda Mining Company. The number of independent unions in each plant has been the basis of objection to trade unionism by industrialists. They say that they are willing to deal with one person representing all of the workers but not with as many as 5 or 10 or even 15 separate unions. The metal trades department insists that through the department system of negotiating you eliminate the difficulties to which employers object.

About 14 years ago I remember hearing a paper by a professor of economics at Columbia University in which he forecast that the American type of trade union would disappear or at least would be weakened in its functioning and that we would end up with a new type of organization which he called the company union. That was in 1921. He foresaw it as a new type of collective bargaining. He felt that this would be much more effective than the type of bargaining you get under the regular trade union. At that time there was a very definite spurt in the development of this type of trade union organization.

These organizations are sometimes called employee-employer relationship plans. Sometimes they are called shop councils. The employers of the country object very strenuously to calling them the "company unions". Irrespective of what they are called, the fact remains that there are people in this country who feel that this type or organization is more effective in bringing about amicable labor relationships. We in the Department of Labor during the past year have been very much interested in finding out the extent of such organizations. We made a sample study of something like 25,000 firms. We attempted to measure the extent of these unions, what they do, and where they are. In addition to that, we have made field studies to visualize what happens in the organizations themselves.

In the firms from which we received data, we find a very interesting situation. You find that something like a little less than one percent of all company unions in existence were started in 1900. Between 1900 and 1914 the growth was insignificant. During the War period the number greatly increased. A very large number of them, about 14 percent of those in existence today, were started then. During 1920 and 1922 a lot more were started. Between 1923 and 1929 about six percent of all in existence were started. During 1930-1932 the number decreased. Then came the N.R.A. which outlawed company unions. Sixty-four percent of all in existence were started between 1930 and 1935.

In plants with less than 50 workers about 85 percent of the firms deal with their workers individually, about 14 percent with regular unions and less than one percent with company unions.

In plants varying from 100 to 199, workers' individual bargaining becomes less frequent and trade unionism gets proportionately greater and the number of firms who deal with their workers through company unions is insignificant. So we move on until we get to plants employing, say between 200 and a thousand workers. The number dealing individually gets less and trade union bargaining grows. In other words, the average plant of less than a thousand is the plant in which the trade unions are concentrated in the largest numbers. As the plants grow larger, trade union bargaining gets less and less, but company unionism grows. When you get to plants of 5,000 or over, about 55

percent deal with their workers through company unions.

What this means as to the future we don't know, but it does mean this as to the present; you have a group of organizations that are doing specific things. I think some employers honestly believe that they get better relations with their workers than by action through company unions. By and large, most of these employee and employer plans do little along the lines of collective bargaining. Some have a lot of the attributes of trade unionism, at least in the sense that they have written agreements and have written records of agreements reached at meetings. On the other hand, by and large, very few of them deal with questions of actual bargaining for the workers as a group. In half the cases they discuss these matters but in terms of actual coming to agreements which are put down as a record for the worker to read or as a written agreement signed by both sides, that is not common. Very few have provisions for arbitration.

In the past few months there has been a tendency on the part of different company unions to get together and make more or less uniform demands. This has not been true in the past. It may be that this trend is the basis for a new type of national organization which will eventually be taken over by the older trade union organizations and absorbed into them.

WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF ALTERNATIVES OF CAPITALISM?

By
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When I first studied under various professors this question of the advantages and disadvantages of different economic systems, we analysed this system which we call capitalism, and then we always compared with it certain abstract systems such as anarchism, communism and socialism. That is, capitalism was a reality; it was the system which we had. The other alternatives, socialism, anarchism, and communism were treated as abstractions.

There is an obvious difficulty in comparing an existing system with something that is only a figment of a mental process, and that is what we were doing when we compared capitalism with other "isms". At the present time, in making a comparison of different economic and social systems we have at least the practical advantage that it is possible to compare the system which we have in the United States, namely capitalism, with other systems existing in the world which are not at least this type of capitalism. That makes a very great difference in the kind of analysis which one can make. In some respects, it is a very satisfactory kind of analysis; in other respects, it introduces very considerable difficulties. There arise questions such as these: Is the Soviet system in Russia socialism, is it communism, or is it analogous to some other kind of abstract system? The same sort of questions arise if we try to compare the capitalism which we have in the United States with National Socialism in Germany, or with Fascism in Italy or with the new kind of economic order which seems to be in the process of development in Japan but to which no one has yet given a name which is generally current.

What I am going to do is to lay abstraction almost entirely aside and take capitalism in the United States, as an existing system, and then consider its advantages and disadvantages in comparison with the existing alternative systems, Communism, National Socialism and Fascism.

Now, I am aware that a great many of you may take exception to this kind of analysis. It raises such questions as this: Is not Fascism in Italy simply capitalism? Is not National Socialism in Germany simply capitalism also? I suppose a communist would answer that they certainly are. A communist would say that National Socialism and Fascism are after all two different names given to practically the same thing. A communist would further say that both represent a late and decadent form of capitalism. Of course, you can use words to mean whatever you like. So, it is perfectly possible to say that National Socialism or Fascism is a form of capitalism, and in that case I would be ruled out of discussing these systems as alternatives to capitalism. However, it is my own belief that the kind of capitalism, if it can be called that, which is in existence in National Socialist Germany or in Fascist Italy is so greatly different from our own system that it is perfectly proper to consider both of them as alternatives to this system which we have in the United States, just as truly as the system in Russia is an alternative.

I am not going to attempt definition or discuss at great length what the system which we have is. I have a series of adjectives which I ordinarily apply to it. I say that we have laissez-faire, democratic, parliamentary capitalism in the United States, and I conceive of these adjectives which I have used as being fundamentally characteristic of this system. I know, right to begin with, that a very great exception will be taken to

these adjectives which I have used to qualify the term capitalism as it exists in this country. I am sure that a great many people would say that it is ridiculous to speak of this as a system which is democratic; to speak of this as being laissez faire capitalism when the assumption of competitive prices is becoming more and more unreal; to call the system democratic when we know that the control of economy is not exercised in a democratic fashion.

It is quite natural that all these objections should be made. I should say, right to begin with, that when I say democratic I refer to the particular kind of political system which happens to be associated with the economic system which we have in this country; I do not mean to say that the economy of capitalism is democratic, **for obviously it is not.** Let me say parenthetically that no doubt there will even be considerable objection to calling the political system democratic, but after all, I believe that we all understand what "democratic" means and can agree that it is a term which is applicable to the political system which goes along with capitalism in the United States, at least if we placed quotation marks around the term "democratic".

So, now to turn to one other aspect of the comparison which I expect to make as to advantages and disadvantages of alternative economic systems. I am sure as I discuss them and as I point out some of the disadvantages which are common to communism and fascism and national socialism, the question which will at once arise in almost everyone's mind is this: Admitting that these are the other systems in existence in the world, does it necessarily follow that they are the only alternatives to capitalism?

I can only say at this time, first, that Communism in Russia, Fascism in Italy, and National Socialism in Germany are actually in existence, and that all three came into existence through the seizure of power. We do not have any example whatever, on the other hand, of a system of socialism which has come into existence by peaceful, parliamentary means. Now, I don't say certainly, of course, that socialism could never come into existence by peaceful, parliamentary, and democratic means. On the basis of the evidence, however, it seems to me unlikely that this will happen. If one looks over the situation in the world at the present time, one finds that there is hardly any so-called socialist party in the world that is now energetically and insistently pushing a program of socialism which it actually expects to get put into action in the near future by peaceful, democratic, parliamentary means. There is a question, I suppose, of where socialism begins and where it leaves off. If we speculate on what would have happened if the Labor Party in England had won the election in England few would suppose that the Labor Party would have immediately started to put a system of socialism into effect. It is quite possible that they would have done this or that which one might class as socialistic, but it is almost incredible that they would have started, under the present leadership of the Labor Party at any rate, to install a socialistic system. Whenever a so-called socialist party gets within striking distance of power by peaceful, parliamentary means, for one reason or another it seems always to abandon its socialism. This is not simply accidental and I wish I had time to explain fully why it seems inevitably to be so.

It is natural during the period when the capitalistic system is getting along very well, such as during a period of boom and expansion, that such is not the time when a socialistic party can expect to expand its vote sufficiently to obtain control of the organs of government. On the other hand, however, when you are in a period of severe depression or collapse, either for purely economic reasons or on account of an unsuccessful war, that is the very time when there is a tremendous amount of

dissatisfaction and social and economic unrest, but that is also the time at which one or both of two things are true: Either you develop a radical movement and you call it National Socialism, or Communism, or what not, which is determined to seize the power by violent means; or the socialist parties which advocate achieving socialism by peaceful, parliamentary, and democratic means do not wish at such a time to assume responsibility for the economic order and they consequently embrace some excuse for not accepting the task of governing the country.

Turn now to the experience of Germany. The Social Democratic Party, which supposedly was a Marxian party, at the close of the war in 1918 when the government of Germany was delivered over to it, was not willing to take responsibility for trying to set up socialism at that time. It is very easy to understand why they did not. It can be very easily pointed out that at that time the Allies might have marched into Germany and imposed another government by force if there had been an attempt to set up socialism. It is easy to point out that at that particular time, Germany's economy was in a very bad shape on account of having gone through four years of war, with consequent difficulties in making replacements and repairs and taking care of depreciation etc., and that there was a shortage of almost all raw materials. These things can be offered as an explanation of why the Social Democratic Party did not choose to try to install socialism in Germany. There were, of course, other reasons as well which I cannot go into at this time, but the fact remains that they did not do it.

During the years just before Hitler came to power, when the whole question of what was going to be done about the depression which Germany suffered arose in its most critical form, although the Social Democrats did not then have the opportunity to take power, it was still true, I think, that they would not have taken it if they had had the chance. Once more the leaders of the Social Democratic Party in Germany had a way of saying "Well, things are bad now. This was not a socialistic system that broke down; it was a capitalistic system that collapsed. It was the fault of the capitalists, let them fix it up, and after it is fixed up, maybe some day we will take it over, but not now when it is in such bad condition".

So much for the historical evidence. So much, which, of course, is quite inadequate but will perhaps serve for the moment. Likewise there is this: In a period of economic boom, of economic expansion, of prosperity, the population in general cannot be expected to vote and to support a change in the economic order. But even at the worst point in a depression you have a very large proportion of the population which has benefited from the capitalistic system; who do not suffer badly enough to make them desire to give up the system; who know that if the system does succeed in recovering from the depression, that if and when recovery takes place they will certainly be far better off from their own personal standpoint than they would be under an alternative system such as socialism. There is a large enough group which benefits and has a considerable stake in the capitalistic system and which is still strong enough even at the worst of the depression that it could hardly be expected that they would permit a change-over from a capitalistic system to a socialistic one by peaceful and parliamentary means.

Now, to proceed with a consideration of the advantages and disadvantages of alternative systems. I am going to begin by comparing the disadvantages and advantages of all these grouped together, that is, I am going to say that there are certain advantages and disadvantages to be found in the Soviet System, Fascism, and

National Socialism, all lumped together. There are some differences, it is true, between these three systems, but there are a great many of the advantages and disadvantages as compared with capitalism which they have in common. Now, this is another place where I realize there will be a considerable difference of opinion. How is it possible to lump together for purposes of comparison systems which are as different as communism on the one hand and National Socialism and Fascism on the other?

My answer in the first instance is that I do not think they are so different as is commonly believed. While I would be the first to admit that there are striking differences between them, yet in a fundamental way the resemblances are greater than the differences. The differences are, of course, obvious and from certain points of view perhaps these differences are so great as to set National Socialism and Fascism quite apart from Russian communism for purposes of comparison. I know that the controlling group in Russia is proletarian in origin to a far greater extent than are the controlling groups in Germany and Italy. That does not mean merely that the fathers and mothers of the rulers of Russia were laborers. It means that a tremendous proportion of the present rulers were laborers themselves; that they were of immediate proletarian origin. There are, of course, well-known exceptions to this, but the group that runs the machinery of the economic and political and social system in Russia is overwhelmingly proletarian. And there is not the slightest doubt that the change which took place from the old Russian system, the particular system of capitalism which they had in Russia, over to communism was tremendously more painful to the middle class, the aristocracy and the peasantry than any change which might take place under National Socialism, or Fascism, or any system similar to them. Now, that difference, I say, is so striking that from some points of view it would immediately set communism in Russia on one side, and on the other, National Socialism and Fascism. But I wonder whether the mere matter of origin makes so much difference? Some at least of the capitalists in the United States are proletarian in origin. Of course you would naturally expect that the point of view of proletarians who come at once into control of the government as proletarians, would be very different from that of proletarians who either immediately or through two or three generations evolved into capitalists and came to control a capitalist economy. Of that there can be no doubt whatever, yet I still return to my previous statement that the difference in the origin of the ruling class is of not so much difference; what really counts is how the power is actually exercised.

Turning at last to the direct consideration of the advantages and disadvantages, one of the first things which can be said of the possible alternatives to capitalism is that distribution in all these three systems seems to be more nearly on a basis both of function and of need than in the capitalist system. It is often said that under capitalism you have distribution according to ability, while under communism you have distribution according to need. Well, comparing this country with Soviet Russia, one would have to say that both statements are somewhat incorrect. As far as Soviet Russia is concerned, distribution now is by no means wholly according to need. In Soviet Russia there are still marked differences in wages, and not only wages and payments in money, which do not make so much difference in Russia, but in the allocation of apartments, in the right to dine in certain restaurants, the right to possess a car, the right to subscribe to certain professional magazines, and in many other things which affect real income. These differences in income exist primarily on

account of difference in function. There is not, of course, a complete distribution according to ability in that there is very definitely an upper limit in practice on the amount that a man is allowed to earn. Lately, however, there has been a tendency to permit fairly large earnings on the part of laborers, engineers and others.

Now, in the United States, it is true that we have to some extent distribution of income according to ability, but that is very strongly modified by the fact that income depends not only upon ability and the opportunity to exercise that ability, but upon ownership of property. That is, if you have more stocks and bonds, or more land, or any form of property than someone else, these increase your income quite without regard to what your ability happens to be. I suppose if your ability is small enough you may, of course, eventually lose the property unless it has been properly tied up by a more far-sighted relative from whom you may have inherited it. As far as Soviet Russia is concerned, however, distribution has been put on a basis of function or of need and property has been put out of the picture.

Now when we turn to Germany or Italy we do not have by any means such clear-cut distinction between property income and functional income and there is by no means such a complete going over to the basis of paying one according to the services rendered to the state. There is, however, a general aim that the economic and social system should evolve toward a condition in which income is made to fit as nearly as possible service to the state. Obviously, you still have private property in Germany and Italy. Those property rights, however, are considerably modified. A corporation in Germany is still allowed to earn profits, but if these profits are then taken by one means or another and used to finance re-armament or for purposes of financing relief or for compulsory donations to the Nazi party or for an export subsidy, I admit that is far different from Communism, but it certainly is not old-fashioned capitalism.

It is a possible advantage that in a totalitarian state, such as the three I have used for purposes of comparison with our own, you have suppression of overt forms of the class struggle. I am not at all sure that is actually an advantage. Strikes, for example, are suppressed in Germany and Italy and Russia, but latent class bitterness is perhaps more bitter than ever. It is unchallengeable force which prevents its open expression.

It has frequently been said that in these totalitarian states there is a greater place for youth than in the capitalist system. As far as Russia is concerned, one can say that in a general way this is true. The country is being industrialized at a terrific pace and, as a consequence, there are a tremendous number of openings in which youth can find a place. This is partly because Russia is passing from an agricultural form of development to an industrial form. Yet it is probably true that the form of the economic system is mainly responsible for the lack of unemployment.

Turning to Italy you find there a great insistence on the importance of youth also. One of the tremendous factors in developing National Socialism in Germany as well, in building the great mass support which that movement attained, was the bitter hatred of youth against an economic order in which it was unable to find places in the professions for which it had been trained. National Socialism, for a time at least, gave an outlet for the energies of youth. They could march around and sing songs and beat up their antagonists and thus give expression to patriotism and vent to pent-up emotions. Whether in the long run National Socialism has much to offer to youth, depends in a large measure on its economic success;

whether it succeeds in establishing itself as a going economic concern. Furthermore, I think that a casual observer of the system in Russia or Germany or Italy gets an exaggerated impression of the enthusiasm of youth for the different kinds of activities which are put on for their delectation. It is perfectly true that for the first year, maybe, speeches about the glory of Russia, Italy, and Germany; Stalin, Mussolini, and Hitler, may be thrilling, but listening to them month after month, they rather lose their ability to stir up enthusiasm. There is a certain regimentation of the enthusiasm of youth in all these countries which is quite obvious. A typical youth has to attend endless meetings in Soviet Russia and in Nazi Germany regardless of whether or not he feels any enthusiasm about listening to the speeches there.

These are some of the advantages of the totalitarian system, if advantages they be.

There is nothing new about the disadvantages. First, there is the suppression of individual liberty. In neither Germany nor Russia nor Italy is there freedom of speech, of the press, of assembly, of conscience. It may be argued that those are purely bourgeois concepts. You may say that as far as the great mass of people are concerned such liberty has no reality. It may be argued that the only real liberties are economic ones; that from the standpoint of the great mass of people all kinds of freedom and liberties of this sort have very little importance. I do not think that is true. Just consider how well the great mass of the people like to serve in the army. Just the sense of being able to say the things which you happen to want to when you want to means something even to a man of the lowest income class. This is not to argue that by contrast we have personal freedom in all parts of the United States for all people. It is perfectly true, too, that a man begins to worry, for example, about freedom of the press in a big way only after he has taken care of filling his stomach. Consequently, in some degree, these liberties are class liberties. No acceptable civilization can exist permanently, however, in absence of these particular liberties.

Another kind of disadvantage of totalitarian states is the inculcation of hatred in their citizens. In Soviet Russia it is not national hatred, but class hatred, whereas it is the former in Germany and Italy. From any point of view this is a most serious disadvantage which needs little discussion.

Come now to another type of disadvantage or advantage which is in an entirely different category. How about the technical efficiency of these three orders - of capitalism as compared with that of the economic system in the Soviet Russia or in Germany or in Italy? It is very difficult to give a simple and easy answer to this question. It is obvious that under capitalism we have had an enormous technical development. We have developed a standard of living which I suppose has never existed on such a wide-spread scale under any other system. Over against that we know that there are certain classes in all capitalistic countries that fare badly even in the best of times. It seems further to be characteristic of the capitalistic system to have depressions during which a tremendously large number of the people suffer.

When one considers the technical efficiency of Communism in Russia as compared to that of Capitalism in the United States, the answer is not at all easy because Russia has gone through several periods in which the material well-being of the people has undergone critical changes. There was the great famine of 1921. Hardly anyone could hold that strictly against the Communist system because it happened to coincide with the end of the civil war in Russia, which would have wrecked the country even if there had not been Communism. When I was in Russia

in 1930 which was, on the contrary, a time of extreme activity, it then seemed that if Russia succeeded in getting by that transition period things ought thereafter to go generally upward. Actually that proved not to be true. Particularly in 1932 there was a distinct downward movement and when I was in Russia in the first months of 1933 the shortage of food was almost catastrophic. Since then things have got much better again. As yet certainly the Soviet system has not succeeded in attaining a standard of living comparable to that in any of the Western European countries or in the United States. Even so, we cannot forget that Russia was a thoroughly backward country and that such a comparison is for most purposes unfair. We consequently have to leave the question of relative advantage and disadvantage in this unsatisfactory state. The question cannot yet be answered conclusively. We can look at the evidence and say that attainment comparable to that of capitalism certainly has not taken place. Whether it will happen in the future one cannot say.

Turning to Nazism and Fascism, the situation is again not simple. Since National Socialism came into being, employment has tremendously increased. The great re-armament program, public works, and labor camps help to explain, perhaps completely explain, increased employment in Germany. When you come to the question of wages, I think it is true that the average wage has not risen since National Socialism came into power. Average real wages are certainly lower. Still, I believe that for one reason or another the laboring population in Germany is better off materially than if there had been no National Socialist regime, simply because so many more are employed. However, we do not know how long that will continue. We do not know how long Germany can stand the financial strain or how soon the re-armament program will result in a war. And war is very probable. The likelihood of war is one of the most serious disadvantages of both National Socialism and Fascism. Fascist states seem to be founded on a kind of psychology that pushes steadily towards war.

I have considered a lot of things which really cannot be satisfactorily compared on the level on which I have attempted them. In conclusion, there remains unanswered this question - how much can you change this system which we have, and still call it the capitalist system? Significant as it is, this question must remain unanswered due to lack of time. Whether or not we will be confronted ever in the United States by a real decision between the system which we have now, or some modification of it brought about by peaceful means short of socialism, and a system such as those in Russia, Germany or Italy, depends primarily on whether capitalism will continue to work. If capitalism can avoid depressions and war which weaken the system to the point of collapse, then as a matter of personal preference, I would choose the capitalist system. Supposing that the choice is actually left in our hands and that certain improvements can be made, it seems to me that the advantages of this system would be very much greater than the advantages of alternative systems. If capitalism can cure itself of depressions and wars, however, the question of choice will likely remain an academic one. That, however, is a large "if".

BUSINESS CYCLE THEORY -- CAN DEPRESSIONS BE TEMPERED OR AVOIDED?

By
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My topic is the question as to whether there are means available whereby the severity of business fluctuations can be lessened. It is a topic certainly wide enough to give me plenty of room, although it may not be narrow enough to enable me to reach any particular destination. To avoid confusion as to issues, I will rigorously restrict my interpretation of business fluctuations to the special sense of fluctuations in the ratio of employed resources to employable resources willing to accept employment at prevailing rates of pay. In other words, I am not going to deal with the questions as to what can be done to eliminate fluctuations in money income, or in real income, or in profits, or in wage rates, and will confine myself to this one general question: Are there ways of reducing the fluctuations in the ratio between employed resources and employable resources?

I cannot very well deal with the question of remedies without saying something about my interpretation of the nature of the problem. For some reason or other, there seems to be an irresistible tendency among speakers on business cycle problems to resort to medical analogies, and I am going to do likewise. I will argue, from the analogy of cancer, that there is a predisposing element in our present-day economic organization, an element of cell structure, which is a necessary factor in contributing to fluctuations and that that structural element consists of price-rigidities; that the price rigidities themselves are not an active agent, but that their existence enables other factors of irritation or disturbance to produce fluctuations in the ratio of employed to employable resources, and that, moreover, in the absence of price-rigidities substantial fluctuations in this ratio are inconceivable. All the theories of business cycles that I know anything about and that have in them an element of valid explanation of the employment cycle take for granted tacitly or explicitly, or involve in some way or other, the existence of price rigidities.

I use "price-rigidity" to mean a failure of the prices of particular commodities to move in the direction and degree necessary to clear the market without reduction of total output when demand in the Marshallian sense is falling for commodities in general. I thus admittedly and deliberately reduce my argument to a near-truism. But I do not concede that I thereby deprive it of significance. The more I read of the history of economic thought the more I become convinced that its progress has consisted largely of the establishment for later generations as truisms of propositions which preceding generations either ignored, or disputed, or accepted without full recognition of their implications. I am thus contending that if all prices were so flexible that adjustment to changes in demand would be made through price changes, and without involving changes in the total output of commodities in general no productive resources of employment would ever be involuntarily unemployed, allowance being made for time lost in the shift of resources from one occupation to another, and for other such minor frictions.

It is sometimes said, in connection with the argument that perfect flexibility of prices would guarantee complete employment, that the flexibility would under some circumstances have to extend to the point of negative prices, or of payments by the factors to the entre-

preneur instead of the other way round. This is not correct if unemployment is defined as I have in effect defined it, as inability to obtain desired employment. At a negative, or even zero price, and for labor at positive prices if they are very much below the hitherto customary rates, the resources would prefer unemployment as the lesser of two evils. This line of reasoning does, however, serve to bring out the important point that what people desire is not merely full employment, but full employment at satisfying rates of remuneration, and that since there are circumstances under which both objectives cannot simultaneously be attained there is always resistances of measures which would promote the fuller employment at some cost, real or apparent, to the level of remuneration per unit of employment. In other words, since certain price minima are regarded as good in themselves, unemployment sometimes results from a more or less deliberate preference on the part of individual laborers or entrepreneurs, or labor leaders, or politicians, of unemployment at high nominal rates of remuneration to employment at low actual rates of remuneration.

I should also point out that occupational and regional immobility of the factors of production, another structural element in our economy, makes the degree of price flexibility necessary to obtain one hundred per cent employment of resources greater than would otherwise be necessary, and at the best introduces a time-lag between a change in conditions adverse to employment and full adjustment to such change.

I concede, therefore, that the problems of the business cycle would not all be solved if there were complete price flexibility, since while price flexibility would guarantee full employment it would not guarantee satisfying -- or even tolerable -- rates of remuneration, absolute, or relative to what other factors were getting at the same time or the same factors had been getting at some previous time. But business cycle theorists have in the main, and I believe rightly, dealt with unemployment -- especially of labor -- as the chief evil of depressions, and I believe -- though I do not know how I could prove -- that with anything like an approach to perfect flexibility of prices, the changes in the real remuneration of important factors, both absolute and relative to other important factors, would be over the short cycles fairly moderate while employment remained approximately complete. If the fluctuations in the volume of employment could be eliminated from the business cycle, it would still remain a substantial evil, but its magnitude would not be of the tragic order which it has attained in the present depression.

Now, I claim -- and this perhaps may present a basis for later attack to the gentlemen who are sharpening their stilettos at the side table -- I claim that every existent theory of the business cycle entitled to serious consideration involves as a vital underlying assumption that there is not a complete degree of price flexibility in the sense in which I have used the term. As a test, I will select from the many types of business cycle theory that are current, the two which at first sight seem most difficult to handle from this point of view. First is one which seems to introduce a quasi-physical element into the business cycle, the so-called law of acceleration of demand, so ably explained by Professor J. M. Clark. Stated in its simplest terms, it reduces to the argument that if, for instance, the demand for a finished product increases in a particular year by 10 percent and

if the depreciation rate of the equipment producing that commodity is 10 percent per annum, and if in the preceding year the existing equipment was all in use, the amount of increase in that equipment required in that year will be 100 percent, in other words, a hundred percent increase in the current output of producers' goods is required to provide for a 10 percent increase in the demand for consumers' goods, and conversely in case of a decline of demand for the consumers' goods.

Take the illustration which Clark has used of locomotives. If the volume of traffic on the railroads falls in a particular year by 10 percent, the demand for new locomotives can fall to zero if there had been a 10 percent rate of depreciation of locomotives, because by using the locomotives released from use by the 10 percent fall in traffic the necessity of replacing worn-out locomotives can be postponed for the time being. So, the 10 percent fall in railway traffic would mean a 100 percent fall in the demand for new locomotives. But I would contend that to make this particular procedure the profitable one for the railroad requires the existence of a complex set of price rigidities. Locomotives tend to remain the same in price through boom and depression; they have a rigid price. There is no particular inducement, therefore, to the buyers of locomotives to do their buying in a depression year rather than in a boom year. Demand for locomotives comes from an industry whose own prices to the public are rigid, with the result that the cyclical fluctuation in its volume of traffic, and therefore in its need for locomotives, is further accentuated. Demand for freight services, in turn, has an accentuated cyclical pattern because the industries requiring such services maintain rigid prices for their own products. There are no relative differences in the fluctuations of demand as between goods of different order of approach to the consumers' goods stage which would necessarily involve major relative differences in the physical output of such goods if there were a high degree of flexibility of the prices of various classes of goods. With perfect flexibility of prices, business fluctuations would take the form of relative fluctuations in the prices of different classes of goods, and, to a lesser extent, in the outputs of different classes of goods, through transference of productive resources from one type or production to another, but would not involve major fluctuations in the employment of resources.

If we turn now to another class of cycle theory, the theories that are essentially monetary explanations of business fluctuations, we come into touch with a persistent conflict between two trends of economic thought, a conflict that can be traced back to the period, so closely comparable to our own, following the Napoleonic wars. There was formulated then the famous James Mill-J. B. Say doctrine, which at a period when severe depression and unemployment recurred repeatedly after short intervals of prosperity, attempted to demonstrate the logical impossibility of the occurrence of such phenomena -- perhaps the outstanding case in the history of economic thought of the ivory-tower theorist demonstrating theoretically the necessary persistence of sunshine while a storm was raging about the tower.

That men of unquestioned ability should have been able to reach such a conclusion is not so extraordinary if we grant them that they were tacitly assuming that all prices were perfectly flexible, and such seems to have been the case. We must even restrain our astonishment that they should have been able to keep so extreme an

assumption implicit, not only in their exposition, but apparently also in their own thinking, for the identical performance has been repeated by at least one distinguished theorist during the present depression.

At that early period, however, there already was a group of writers who replied to James Mill and his followers that there were important price rigidities, and that the doctrine that any output, whatever its size, could always find a market and that therefore overproduction was impossible rested on the contrary assumption that all prices were adequately flexible. Present-day writers tend to credit Malthus with leadership in this connection. But not much more can be said for Malthus than that he saw that there was something wrong in the James Mill type of reasoning, as taken over by Ricardo and the younger Mill, but failed to identify just what the error was. It was the two Attwoods of Birmingham, Wheatley in his later writings, and even more obscure writers, who really exposed the fatal flaw in the James Mill doctrine. The subsequent line of economists, unfortunately tended on the whole to follow James Mill rather than the Attwood version.

All monetary theories of the cycle explain the fluctuations in the volume of employment by fluctuations in the volume of use of money in making purchases of commodities. But if the prices of commodities and the prices of factors were perfectly flexible, then whatever happened to the volume, or velocity, of money, you might get cycles in price levels, you might get cycles in income measured in money, but you would not get cycles in ratio of employed to employable resources. All monetary theories, whether they are theories explaining the cycle or whether they are theories as to monetary remedies for the cycle, involve either the assumption that there are no price rigidities, or the assumption that through manipulation of the supply of money you can compensate for the effect of price rigidities.

Examination of the causes of price rigidities in our structure is an important preliminary to examination of the possibilities of dealing with the problem of rigidities. Price rigidity is not exclusively a modern phenomenon. There is a tendency on the part of a good many people, including economists, to attribute to yesterday the origin of all phenomena which they themselves first noticed yesterday. I am not even sure that there has been any marked increase in recent years in the price-rigidity of our economic structure. The easy generalizations to this effect which one constantly encounters are not based upon historical research, as far as appearances go, and some inquiry I have made, though on a restricted and tentative scale, suggest that there is need for caution in accepting the common view. Thus the available price series for English commodities during the period 1800 to 1830, a period of disturbances in price levels comparable to those of the past thirty years, display to casual inspection at least as much rigidity of particular prices as prevails in the modern period. Studies of the trend of wage rates in England in the eighteenth century show rigidities of the wage-structure which easily exceed the rigidities of wages under modern collective bargaining. It may be possible to explain away such historical data, but until this is successfully done, we had better accept with caution the current belief that price-rigidities, in kind or in degree, are a modern disease. But the causes of price rigidity have undoubtedly undergone change in the past century. The older price-rigidities were probably attributable

in large part to the force of custom and to sluggish market mechanisms, factors which have since shrunk greatly in importance, whereas the modern price-rigidities are obviously due in the main to other factors. Though the causes of price-rigidities may have changed, the consequences have not.

These modern price-rigidities are, I suppose, a manifestation of what the Marxian socialist calls the inherent contradications of capitalism, and the faithful Marxian, I presume, hopefully believes that these price-rigidities are steadily getting worse, and will in due time produce that social and economic catastrophe out of whose wreckage the socialist millenium will be constructed. That the rigidities have been getting more serious is probably true, but it is conceivable that this has been due not to a decrease in the average flexibility of prices but to an increase in the importance for our economic life of the market and of market prices.

The great bulk of our economy is controlled by the market and its prices, whereas in the eighteenth century in England, and to even a greater degree in the early nineteenth century in this country, a substantial portion of the national income came from home production on a self-sufficing or near self-sufficing basis and therefore largely independent of business fluctuations. Moreover, that large fraction of the population which could provide the major part of its absolute necessities without recourse to purchases or sales in the market could also, in times of distress, provide food and shelter and work for relatives who in the good years found their livelihood in the towns by working for wages or producing goods to sell. This safety-valve in times of depression has not yet wholly been lost in this country, but its importance has greatly diminished.

One other factor may be operating to make price-rigidities of given degree more ominous, and that is that the public's tolerance of imperfections in the working of our economic system may be decreasing. To be certain as to this, we will have to await another boom and severe depression -- when it may be too late to profit from the lesson. In any case, whether price-rigidities and their consequences are growing in importance or not, I do not suppose that anyone will dispute that the evil is a serious one, serious enough to justify anxiety that remedies for it be found, and be found quickly.

In considering the causes of present-day price rigidities, custom may be disregarded as not being very significant, unless we include under that classification the prominent item in the moral code of business which looks upon price stability as an economic virtue and price-cutting as the most heinous of ecoomic sins. "Stability" is often merely a euphemism for "rigidity," but so beneficient-sounding is the word stability that if you were to advocate stabilization of unemployment it would take some persons a moment or two to realize that there was really not much to be said for that particular type of stability. It should be added, of course, that the hostility of business men to price instability is really confined to a prejudice against downward movements of prices, and especially of the prices of the things which they have for sale, and that businessmen have even been known to act in concert in order to obtain an upward change in the prices of their particular products. The objection to price instability, therefore, has operated more as an obstacle to price-reductions than as a barrier to price increases, and has consequently been

more of an evil during depressions than during booms. Business men, moreover, can claim in defense of their resistance to price flexibility in a downward direction that government has often given moral support to their attitude.

It is in connection with wage rates, however, that the belief that reductions are always undesirable is most widespread and goes deepest, and there are many persons, not all of them labor leaders, who seem to think that whatever ails mankind, whether it is a boom or a depression, an increase in wages can cure it. This belief operates as a useful restraint during periods of too rapid business expansion, but as an obstacle to wage reductions during a depression it contributes powerfully to intensify and prolong the depression.

In this connection the new doctrine that depressions can be lessened by the maintenance by artificial methods of "balance" or "parity" between the prices of different classes of commodities at the levels prevailing during prosperous years threatens to produce new barriers to price-flexibility. Although there is no logical basis for this doctrine, action in accordance with it might conceivably operate beneficially if it took the form of pressure to break the most rigid prices. Since, however, it is not based on any economic principle which will withstand examination, its application is likely to follow the path of least resistance, namely, artifically to maintain at or to restore to their prosperity levels the prices which if left alone would be flexible, thus universalizing price-rigidity instead of promoting price-flexibility. Price-flexibility involves relative fluctuations in prices, and therefore flexibility in the ratios between prices, rather than flexibility in price levels as a whole. In fact if all prices were flexible, price levels would be much more stable than if portions of the price-structure were rigid, since it is these rigidities which are responsible for the severe fluctuations in business activity which are in turn responsible for the severe fluctuations in price levels.

A contributing factor to price-rigidity which does not receive the attention it merits is the general accounting practice of computing costs for all purposes on the average rather than the marginal or differential basis. Business men, fortunately, do not always follow the advice of their accountants, but insofar as computations of cost enter into their determination of prices and insofar as they do follow standard accounting practice, they tend to increase their prices less during prosperity, and to decrease their prices less during depression, than is to their own selfish interest. To illustrate the perverse operation of average-cost accounting, I will take a hypothetical example which is extreme but in principle fits countless realistic cases. Demand for a product falls; sales and output fall; the overhead costs, being fixed in the aggregate, rise per unit; average cost therefore rises. On the principle that selling below cost is both unprofitable and immoral, price is raised. The volume of sales and of output thereupon falls still more, and average cost rises still further. Therefore, the price is again raised, with similar consequences. Finally, the problem is solved by setting an infinite price and producing zero output. A concrete illustration of action based on this logic and leading in this direction, although not yet carried far enough to reach its logical goal, is to be found in the recent history of railroad freight rates, with government as an important participating agent in this process of economic suicide. Traffic having fallen during the depression, the railroads demanded higher rates and got them, whereupon traffic fell

still further, and the railroads moved still closer toward bankrupting themselves and their customers.

Business stupidity, however, even when abetted by government and by the accounting profession, does not suffice to account for all of the injurious rigidity of prices which has manifested itself during this and previous depressions. In general there tends to be, or there seems to be, low elasticity of demand for particular commodities, taken singly, especially in the short run. In non-technical language, a particular industry has ordinarily little reason to suppose that if it reduces the price of its product, other prices remaining unaltered, volume of sales will increase sufficiently, and sufficiently quickly, to prevent its net income from falling. The gain from price-cutting that is important during a depression is not the gain to the price-cutting industry itself, but to other industries and their employees. Even if business men realized this, they could still be expected to maintain their own prices, while hoping that other industries would cut theirs. It would be to the mutual advantage of businessmen, as well as to the country, if at the onset of a depression businessmen conspired to cut prices in concert but their conspiracies, whether during depression or boom, usually have the opposite objective.

Probably more important as a contributory factor to price-rigidity than the business mores against price-cutting in this country, and certainly more important in countries where the cartel form of business organization is legal and prevalent, is monopolistic control of prices. A priori, it is not obvious that monopoly prices will be less flexible than competitive prices, since flexibility of prices may be to the advantage of the monopolist. But the monopolist has even less belief in the profitability of price-reduction than the competitive producer, and, moreover, whether his price shall fall is, within limits, subject to his own decision rather than imposed upon him by market conditions over which he has little or no control, as is the situation of the truly competitive producer. Although exceptions -- few and partial -- can be cited, the general situation therefore is that the degree of price flexibility tends to vary inversely with the degree of monopoly control.

In the recent economic literature much emphasis has been placed on the tendency of competition to become imperfect as the size of the concerns in a particular industry grows and the number of concerns decreases, and of price-rigidity to result even if complete monopoly control of the industry fails to develop. This emphasis on the tendency toward price-rigidity which results from even a partial approach toward monopoly seems to me, in fact, to be the chief useful product of the economic analysis of the problem of imperfect competition now under way on a wholesale scale, and the product would be even more serviceable if it were derived from analysis of the actual price-behavior of actual industries in which price-making is dominated by one, or a few, firms -- rather than from fantastically abstract and unrealistic assumptions as to the price-behavior of firms in such industries. The recent trend toward anti-size legislation, both federal and state, is perhaps also due in part to a vague recognition of some sort of connection between booms and depressions, on the one hand, and imperfect competition on the other. But such legislation as has been passed or is being proposed is pitiably undiscriminating in its nature, hitting size both where size promotes flexibility and where it promotes rigidity of prices. Where size of concerns is the result of the integration of successive stages of manufacture under single management, it promotes flexibility of price by

lessening the rigidity of costs to the individual producer. Where size of concerns is the result of the extension of the range of products of individual concerns, it promotes flexibility of price during a depression by giving the price-cutter on one product some assurance that he will profit not only from the increase in volume of sales of that product but also by the favorable repercussions on the volume of sales of other products. Where size of concerns is the result of efficiency and low costs, it tends also to promote price flexibility and maintenance of business activity because the financial strength of the concern better enables it to withstand the lag between price-reduction and increased volume, and frees it from the necessity of deferring maintenance and replacement expenditures in order to remain liquid and solvent. It is therefore only size measured by percentage of total output of particular commodities controlled by single concerns, and even such size only if due to mergers, promotions, and financial operations rather than to growth from efficiency profits, which contributes substantially to price-rigidities, and thus to prolongation and intensification of depressions.

Another factor of increasing importance contributing to price-rigidities is to be found in the expanding area of governmentally - regulated prices, in the past confined largely to public utilities but in recent years spreading rapidly into other fields of economic activity. Government regulation of prices, if governments reasonably intelligent in their economic policies can be conceived of, might serve as an instrument whereby price-flexibility is promoted. But government regulation in practice operates to substitute rigidity for flexibility rather than the other way round. The history of public regulation of utility rates in this country can, it is true, be plausibly interpreted as demonstrating a tendency of such regulation to make utility rates flexible. But unfortunately insofar as such regulation has not operated to freeze utility rates, it has promoted, or at least sanctioned, a perverse flexibility, a type of fluctuation in rates well-designed only to guarantee bigger and better booms and depressions. First, the fair-return-on-investment principle, interpreted as giving the utilities a claim to a fair return each year, the level of return regarded as fair being treated as constant and independent of the immediately prevailing level of return to investments in other fields, and the dependence of net income on volume as well as on rates being overlooked, operates to supply public utilities with legally valid claims to increased rates during depressions, when such increases have seriously injurious effects on the economy as a whole, and to supply regulatory officials with legally persuasive claims for reductions in rates during booms, when such reductions tend further to stimulate the boom. Secondly, if enlightened public utility managements should recognize the possibility that rate reductions during a depression were in their own interest, they would nevertheless hesitate to introduce them because of their justifiable scepticism that they would be permitted without protracted struggle to raise them again when business conditions improved.

The barriers against international trade also operate indirectly to foster price-rigidities. The more restricted the area of potential competition, the easier it is for monopoly control of a market to establish itself through custom, practice, formal agreement, or concentrated control of output. The tariff shelters domestic monopolies against foreign competition. In the absence of international price agreements, even monopolistic industries would during depressions engage in

price-cutting in each other's markets if not in their own, but tariffs are obstacles to such wholesome activities.

Finally, in the important range of what might be called government prices -- taxes, fees, and other charges -- there is, at the best, rigidity of prices, and at the not infrequent worst, marked perverse flexibility of prices. Because the tax base shrinks during a depression, tax rates are then increased in order to maintain revenue. Because the yield at constant rates of direct taxes, and especially progressive income taxes, ordinarily has a more marked cyclical pattern than the yield of indirect taxes, there is a tendency, moreover, to increased reliance for revenue during a depression upon the taxes most restrictive of output, such as sales taxes and specific excise taxes. Thus in its rate changes and in its structural changes, the tax system tends to be so managed as to accentuate the cycle, and especially to accentuate its depression phase.

I have dealt so far only with price-rigidities as the characteristic of our economic structure which makes it susceptible to fluctuations in employment. With the active irritants which operate to exploit this susceptibility, I do not propose to deal systematically, partly because to do so would involve me in much more complex and much more controversial analysis, where I do not feel nearly as sure of my ground as in dealing with the causes and significance of price-rigidities, and partly because I am inclined to believe that, meager as are the prospects of successful concerted action to moderate the amplitude of the business cycle, the prospects seem more promising if the action were directed against price-rigidities than if they were left untouched, and attempts were made to discover and control all the active factors, which, operating upon these price-rigidities, produce the business cycle.

I have no lack of faith in the possibility of finding effective remedies for severe fluctuations in the volume of employment. On the contrary, I believe that sufficient is already known to make possible a substantial approach to continuous full employment of our productive resources; and that the problem now lies more in getting the patient to take the medicine than in finding a helpful medicine. In a sense a complete remedy for unemployment has always been available, but the disease has not seemed serious enough to warrant so drastic a treatment. Abandonment of the voluntaristic elements of our economy, and submission to management by central authorities with unlimited power to allocate resources to tasks and to force them to execute such tasks, is in fact a 100 percent cure for this problem, and probably the only complete cure. That it is an effective remedy we need not invoke the example of Soviet Russia to demonstrate, for its adequacy is being demonstrated currently in every American penitentiary, where unemployment occurs only as the result of gross mismanagement on the part of the officers. Most of us, I presume, are not yet prepared to regard the disease as bad enough to warrant resort to this remedy. Short of it, nothing like a complete cure is to be expected. The practical question is, are there means, short of an autocratically managed economy, whereby the amplitude of the fluctuations in the ratio of employed to employable resources can be substantially reduced?

Assuming that the problem is to be attacked from the angle of price-rigidities, I see no hope that much can be done through appeals to the

individual business man or labor leader, and I am convinced that improvement can come only through governmental action. What is required, therefore, is, first, the conversion of government and of the voting public to the view that price-flexibility is not only desirable but is urgently necessary, and, second, such conversion having been obtained, to secure adoption of a legislative and administrative program well-designed to build price-flexibility into our economic system. Both of these seem formidable tasks, and there is little in the current flow of legislation and of popular discussion which justifies expectations that substantial progress in these directions is being made. The public, in fact, has during the present depression acquired an intensified faith in the virtues of price-rigidities and has obtained official blessing for procedures aiming at increasing their degree and range. During the present depression governments here, and elsewhere, have probably done more directly to introduce new and to strengthen old price-rigidities -- or perverse flexibilities -- in our economic structure than to promote price-flexibilities. Assuming for the moment that economists are agreed, or can be brought to agree, that price-rigidities are a vital predisposing factor to marked fluctuations in employment, and that the education of the economist himself is therefore not a serious problem, I still have pessimistic forebodings as to the possibility that the economists could within, say, the next decade or so thoroughly convert government and public to the same belief.

But assuming that we are agreed as to the evil , and that we can persuade the government that our advice is sound and can persuade the public to permit the government to follow our advice, what should be the program we should recommend to the government whereby adequate price-flexibility could be secured?

The first step would most appropriately be for the government to adjust its own operations to the business cycle, so that as far as possible they would be stabilizing in their influence and would at least not operate themselves to increase its amplitude. Most important would be a reform of the fiscal procedure of our governments, state as well as federal, such that tax rates would be high and surpluses large during prosperity, and rates low -- and perhaps deficits deliberately large -- during depressions. During this depression we have had the large deficits called for by this program, but there would be less cause for doubt as to their efficacy in shortening and moderating the depression if they were created in execution of a clearly-defined policy adopted during a period of prosperity, so that they could not be mistaken for the routine manifestations of financial weakness. Depression deficits resulting from reductions in tax rates, moreover, would probably be at least as effective as "pump primers," and much less alarming to industry, than depression deficits resulting from increased and patently wasteful expenditures accompanied by unprecedently burdensome taxes. Still better would be the accumulation of fiscal fat during prosperity, to be used up during depression in unemployment relief and in reducing taxes. To obtain such fiscal reform, government must be made "cycle-conscious" even when optimism prevails.

On the general desirability of tariff reductions, economists are in the main agreed, although few other persons agree with them, and the economists themselves have given little attention to the relations between tariff policy and cyclical fluctuations. Unilateral

tariff reduction during a depression is an almost unknown phenomenon, and I am willing to concede, though an ardent free trader myself, that from a strictly national point of view a depression is the least desirable of occasions upon which to reduce tariff rates unilaterally. Tariff reduction, however, is rarely popular under any circumstances, and few governments, whatever their own convictions, are willing to assume the political risks of such reduction at any time. That we have made some fairly significant gestures toward tariff reduction in the midst of a severe depression is a striking phenomenon, and may justify hope as to the possibilities of further movement in this direction when prosperity returns. That Congress and the public have tolerated such action at such a time reveals incidentally how much greater is the influence on public opinion of a few able and courageous statesmen than the manifestos of several thousand economists and their secretaries.

Our entire philosophy and practice of utility rate regulation needs reconsideration and revision in the light of its impact on the business cycle, so that it shall not operate to intensify, and perhaps shall even be made to contribute something to the moderation of, the cycle. The obstacles to reform are, however, in this as in other instances, of formidable proportions. Public utility regulation is the product of the slow accumulation through the years of laws, judicial decisions, and administrative rulings of 49 or more sets of authorities, subject to constitutional limitations operating through interpretations whose changes, though they may occasionally be revolutionary, may also be in the wrong direction. There is no evidence in sight at the moment that the current trend of regulation indicates a growing recognition on the part of the courts or the public utilities themselves of the need for cyclical flexibility in utility rates. The few motions in this direction made by public utility commissions during the depression all seem to have encountered, from the public utilities and the courts, hostility as vigorous as it was unenlightened, and the federal government's handling of the railroad problem could not very well have been worse from the point of view of adjustment of rates to a depression situation, whatever may have been its merits from a political point of view.

I take it for granted that you will agree with me that businessmen will not voluntarily reduce their price unless convinced that such reduction is in their particular and immediate interest. It is conceivable, however, that the structure of business may be so changed through legislative pressure as either to prevent the businessman through competitive pressure from maintaining rigid prices during a depression, or to make price reductions less distasteful to him than they have been in the past. Direct action by the government on particular prices is, outside the public utility field, probably legally out of the question, and is otherwise objectionable, since the risk that such action would be for purposes and in directions which would intensify the cycle problem appears all too great. The line of action for which there is most precedent in anti-monopoly legislation has in the past had for its objectives the protection of the consumer against exploitation and the small, independent producers against unfair competition, and not the elimination or restriction of forms of business organization tending to promote price-rigidity, although this last seems to me a much more important matter. If the legislation had been effective, however, in its stated aims, contribution to price-flexibility would have come as an incidental by-product. The general verdict appears to be that the legislation was on the whole a failure.

But there is ground for the suspicion that the failure was not inevitable, but was due in large part to the fact that except at intervals when public opinion was aroused the battle between the trusts and the government has been largely a sham-battle, with sniping rather than major hostilities, and with considerable fraternizing between the lines.

The current anti-size legislation is perhaps to be interpreted as marking a revival of public and legislative hostility towards monopolies, with size being taken as a presumption of the existence of monopoly power more readily established than logically more adequate stigmata of monopoly. If carried far enough so as to eliminate large-sized concerns over a wide range of industries, it would indirectly promote price-flexibility. But in its first impact, it seems to be hitting concerns which, in spite of their size, have operated to promote rather than to restrict price-flexibility. This is notably the situation in the case of the chain-stores, which whatever their defects, have in their pursuit of volume and their use of price as their main appeal for custom, hot only followed a flexible price policy themselves, but imposed it on their small-scale competitors, to whom it was highly unwelcome. Much of the animus against the chainstores, in fact, comes from their small-scale competitors who don't like their practice of cutting prices and mark-ups to meet a depression situation. If a legislative compaign against size is to be carried on, it seems urgent, from the point of view of price-flexibility, as well as from other considerations, that there be discrimination according to the nature of the industry and the role of the large concerns therein as shown by their past record.

Even if it be granted, as I think it must, that private business -- or labor -- cannot be expected to adopt of its own accord a policy of price-flexibility, a great deal would be accomplished if our governments in their own prices and in the prices over which they exercise direct control would adopt and execute such a policy. But suppose that this does not -- as it undoubtedly would not -- suffice to introduce as much price-flexibility into the economy as a whole as would be required if severe fluctuations in employment were to be eliminated, are there other governmental measures available whereby the unemployment -- or boom -- consequences of rigid prices could be offset or compensated by deliberate action in the opposite direction?

The possibilities which at once suggest themselves are predominantly in the field of monetary and credit control. Time does not permit my engaging in a comprehensive examination of the effectiveness of monetary measures in stabilizing employment, and I must confine myself to a few general propositions stated, in the interest of brevity, more dogmatically than I hold them. Past experience offers little encouragement. With one class of exception, there is not on record as far as I know any clear-cut case where unemployment has been relieved for a substantial period of time by monetary expedients. The one class of exception has received as definite a demonstration of efficacy in the last few years as history ever provides for economic experiments. Its limitations must not, however, be overlooked. During a period of declining world price levels, a country which devalues its currency, or allows its exchange value to depreciate, can, if its action does not arouse retaliation or imitation by too large a

portion of the outside world, check the decline in its own price level and reduce the volume of its unemployment. Based largely on this experience, many economists have jumped to the conclusion that any country, by manipulating the exchange value of its currency can proximately maintain such price-levels and such degrees of employment of its resources as it desires. That there is no historical confirmation of this may be due, of course, either to the absence of experiment or to the mismanagement of such experiments of this nature as have been engaged in. But there are weighty reasons for holding that exchange-manipulation of the metallic value of the currency unit offers no solution for any country for which foreign trade is not a dominant element in its economy and which is important enough so that countries will pay serious attention to what it does. The success of England with exchange-depreciation is similarly attributable to the facts that it was done suddenly, that a substantial portion of the rest of the world followed her, so that there continued to be stability in many of the sterling exchanges, and that after the abandonment by England of the gold standard, it was the exchange value of the currencies not attached to sterling rather than of sterling whose depreciation could reasonably be anticipated. It is to be noted that once England had been off for a few weeks, it was sterling which was appreciating rather than the gold or gold-exchange currencies in terms of the world currencies as a whole. There is still no evidence -- and no adequate theoretical ground -- to support the view that a currency legally susceptible to monetary exchange depreciation and commonly regarded to be so in fact, is an aid to fuller employment, except in the pathological case of a wild inflation where the misdirection of the employment and the distortion from normal of the distribution of its products much more than offset as evils the advantage of full employment.

It may be objected that it is inconsistent in the same breath to make a general plea for price-flexibility and to oppose the elimination of one of the most conspicuous of historical price-rigidities, namely, rigid exchange rates. But the price-flexibility which is beneficial is the flexibility of the prices of particular commodities and services in response to changes in market conditions. Even here violent fluctuations of particular prices are neither desirable nor necessarily associated with complete flexibility of particular prices. The existence of give-and-take in all the detailed atoms in the price structure would, in operation, tend to reduce the extent of the relative changes as between classes of particular prices. A change in the average exchange-value of a currency in terms of outside currencies is not analogous to a change in the relative price levels as between entire classes of prices, export and import, international and domestic, present and anticipated future prices, and these changes can have an amplitude per unit of time without parallel in partial or national price levels under an international standard even during major cyclical fluctuations. The felt risk of exchange depreciation tends to have either of two disastrous effects, first, flight to foreign currency or hoarding of cash with a view to flight abroad or to commodities at the proper time, when depreciation appears as a serious possibility but not yet a certainty, and, second, all

the phenomena of wild inflation when depreciation is progressively under way and its continuance is regarded as certain or nearly so.

These objections to exchange-flexibility apply in much smaller degree to a currency managed with a view to stability of some version or other of the national price level, since the exchange-value of such a currency could depreciate greatly only when price levels abroad were falling substantially, and at such a time the stability of the foreign currencies would, as we have learnt, be regarded with some scepticism, so that the incentive to flee to them would not be great. But assuming no general trend in world price-levels, the fluctuations in the exchange-value of the currency of the country with a stabilized price level would result in repeated booms and depressions in the unsheltered industries, and in protecting itself from general booms and depressions resulting from general fluctuations in the world price-level, such country would render itself subject to a different and sufficiently serious sequence of booms and depressions in the unsheltered industries, or those competing with foreign products either in the home market or in export markets. This is intended not as a criticism of price-stabilization as a partial remedy for employment fluctuations, but only as a criticism of price-stabilization on other than an international basis, or, if on a national basis, if carried beyond the limits set by rigid, or near-rigid, exchange rates.

As to the possibilities of stabilizing employment through a budgetary policy geared appropriately to the problem of the cycle, I have already said something. Much could be expected from this expedient if skillfully administered by governments which saw to it that during prosperity periods they acquired so strong a financial status that their departures from "sound" fiscal policies during depressions did not make the investing public panic-stricken, if the "brakes" applied during expansion took the form of higher tax rates used to liquidate debt, and if the "pump-priming" applied during depression took the form of unemployment relief and tax reduction. The maintenance of public confidence in the financial stability of government is necessary to the successful execution of such a policy, and our recent experience indicates that it would be easier to maintain such confidence if the policy were initiated during prosperity rather than during depression, and if it could be clearly and rationally explained and firmly established as a permanent policy, rather than hastily adopted as an emergency expedient.

Even with all of these measures vigorously employed and skillfully used, there would still be unemployment in the absence of some form of compulsory employment, if all prices were not flexible, and given important rigidities, and especially collective bargaining with respect to wages, conducted, as it generally appears to be, without relationship to the dependence of the amount of employment available for labor on the wage rate, there would be important fluctuations in the volume of employment. While I would by no means plead for contentment with obviously imperfect solutions, it seems the path of wisdom not to despise ameliorations and improvement in our zeal for perfection.

I have not invoked the new magic wand in the field of economics by a touch from which, all economic evils, in a manner unspecified, can be made to disappear, namely, "central economic planning." It is an ambiguous phrase, whose users do not disclose clearly enough at what point in the infinite range between a mythical laissez faire economy and

a completely authoritarian state anarchy disappears and the "planned economy" replaces it. Interpreted literally, central economic planning covers all governmental legislation on economic matters, since who would presume to suggest that economic legislation is not "planned," is not the product of thought about the needs of the national economy? Those who permit themselves to be designated as advocates of more legislation and more governmental control than at the moment exists. In this sense, I do not know whether I am a central planner or not, since while I would support more (or different) legislation than we now have in the direction of credit control, budgetary management, and monopoly regulation, I would favor the repeal of much of our existing legislation which contributes, though of course unintentionally, to the instability of employment. Government regulation of industry, and lots of it, we must nevertheless have, even though some of it will inevitably turn out to be injurious in its effects. It is, moreover, scarcely a matter of rational choice, since when the public is under economic stress it cannot be convinced that no legislative remedies are available. Our chief role as economists has been, and will continue to be, to contribute, by objective study, to the discovery of better remedies and better methods of administering them and perhaps an even more difficult task, to persuade legislators, administrators, and the voting public that we have a contribution of value to make in this field.

SOME CONSEQUENCES OF OUR MONETARY POLICY

By
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It is necessary for me to state at the outset that the theory of money still remains one of the unsettled problems in economic theory. Mr. Sarle told you that economists formerly thought they had discovered the fundamental principles of money. In the last few years, however, that attitude has been changing and there is now a division of opinion among students of the subject. I think it only fair that I state at the outset my own particular bias, or point of view, so that you will not make the mistake of believing that my views are those of the majority of economists.

Most economists strive for an ideal monetary system and on that particular point I think all are in agreement. All economists would like to see an ideal monetary system. The difference between economists lies in the definition of the word "ideal". Now, as I conceive it, an ideal monetary system is one which is adapted to the economic pattern of the country which uses it; one which is in harmony with the other institutions and customs. This must be distinguished from another ideal which sets down certain abstract, ideal, principles at which all monetary systems should aim. So I regard a monetary system as an ideal one if it fits the circumstances whether or not it approaches any abstract principles of perfection.

A second characteristic of my personal bias is this: The idea of a rigid and inflexible monetary system is one which has never appealed to me. I favor flexibility against stability, preferring a system which changes and fluctuates to meet moving circumstances to one with greater elements of rigidity. It is in this spirit that the topic, "Some Consequences of our Monetary Policy", will develop the historical background of our monetary policy. Were this not done some of the things which the Government is attempting at the present time might not be clear.

Among early Federal monetary laws we find in 1791 the establishment of the First Bank of the United States. This was a Government bank destined to provide credit and to stabilize the monetary system. The bank was founded, organized, and given a twenty year charter. It did excellent work in stabilizing money and in providing credit but, in spite of this, the charter was not renewed, upon its expiration, because the people did not like that kind of bank. They did not want a sound and stable money, but a cheap money; a money which would be available geographically to larger parts of the country than any one bank could then make it. There we find an early expression of American opinion on the subject of money. This opinion was definitely against a stabilized monetary system under the control of one Government bank.

A second important act of monetary legislation was that in 1792 when our monetary system was first established. We adopted a bimetallic system with a ratio of silver to gold of 15 to 1. Since the market ratio was about 15½ to 1 no gold coins were

made, and we were practically on a silver standard from 1792 until the ratio was changed in 1834 to $15\frac{1}{2}$ to 1. But in 1834 the market ratio was about $15\frac{3}{4}$ to 1. So after 1834 only gold was coined and for all practical purposes we have been on a gold standard ever since that year.

The second Bank of the United States was established in 1816. This bank attempted to do about the same thing the First bank did -- to give us a trustworthy money and to supervise the money which state banks issued. The supervision which it exercised over these banks made for a sounder currency. It was so successful at doing this that its charter was not renewed when it expired in 1836. So again, the American public had an opportunity to express an opinion on money and it did so in favor of an unstable currency, of a wide geographical distribution of money, of a cheap money, and of a money which was not particularly sound.

Another great landmark in our monetary history was the greenback period which began during the Civil War. The Government was faced with heavy expenditures; it could not balance its budget and carry on the war. The people of those days thought that the war should be pursued and so the Government had recourse to borrowing and finally issued paper money, known as greenbacks. Such large amounts of this paper money were issued that severe inflation resulted and the greenback dollar was at one time worth but 35¢ in gold. Thus the Civil War financial crisis was met by inflating the currency. In 1863 the national banking system was established. The state banks had issued much irredeemable paper money and it was found that, given the crisis which the Civil War precipitated, it was necessary to have a sounder monetary system and at the same time provide a market for Government bonds. Consequently the national banking system was established and an end was put to the paper money issued by the state banks and a market found for government bonds.

In 1873 we took a step towards the adoption of the gold standard. Since 1834 no silver dollars had been coined and consequently the monetary Act of 1873 did not provide for them. Later while studying that law it was discovered that it failed to provide for silver dollars. There arose a hue and cry over the situation; people thought that Congress had met secretly in private and done away with the silver dollar. This issue was made the center of much discussion and has gone down in history under the name of "Crime of '73".

Following this, there arose in the west and south agitation for more and cheaper money. These sections of the country were not in sympathy with the gold standard because they needed credit and felt that it made money "tight". Under the gold standard, they thought, the industrial east could operate, but the agricultural south and middle west could not. A demand for silver money resulted because it was the cheap money people wanted. This demand was logical and justified. There was apparently a lack of money and the credit facilities of the west and south were not sufficient to support their expanding economy. In response to this agitation two laws were voted, one in 1878 and the other in 1890, the Bland Allison Act and Sherman Silver Act, which served to increase the volume of money in circulation. Again the American public had the opportunity to express itself on what it wanted in the way of money.

In 1900 we adopted definitely the gold standard. In 1907, after the crisis of 1906, the National Monetary Commission was appointed. This Commission made an extensive study of monetary and credit systems. In

its report it recommended the establishing of a central Government bank to control our banking system which had shown grave signs of weakness in the crisis of 1906. This report was followed by several years of debate and the legislation which ensued gave us, not a central bank, but the Federal Reserve System. The people did not desire a central Government Bank and obtained in its stead a decentralized banking system as embodied in the law of 1914.

In 1916, it was found that, while industry was well provided with credit, agriculture was not, therefore, beginning in this year, a series of enactments provided for agricultural credit. In 1916 the Federal Farm Loan banks were established for long term farm credit, in 1923 the intermediate credit banks were founded for medium length credit, and in 1923 the National Agricultural Credit Corporations were created.

What does all this monetary history mean? It can be interpreted as signifying that the American people favor large quantities and wide distribution of money in preference to monetary stability. It emphasizes this: That it has long been the American idea to oppose centralized monetary control. It reveals that experimentation has been the rule in our monetary system; we have seldom adhered to abstract ideals. Situations have been met as they arose, but we did not plan for them in advance. Further, study of these enactments reveals that every piece of monetary legislation has been a compromise: special groups and interests have frequently been favored. Further, this country has wanted and has had an expanding monetary system; we have been adding more and more money to meet an expanding economic organization. Our system has been peculiarly American; adapted to a country with a frontier.

So much for the past. Now, what of the present? The depression brought so much misery and stagnation that it became necessary to make some changes in our monetary institutions to meet the situation. We began on the 6th of March, 1933, with the bank holiday. Then some of the banks were reopened while the unstable and insolvent banks remained closed. These acts did much to restore confidence. Then came the anti-hoarding of gold law which was made necessary by the fear that gold would be withdrawn from the banks and the Treasury, put in private hands, thereby weakening the reserves of the system.

Additional measures provided for the regulation of foreign trade in gold, and for the control of gold by the Secretary of the Treasury. A most important step was taken by the act which enabled the President to reduce the gold content of the dollar The Emergency Banking Act, voted on the 9th of March, 1933, provided for the deposit of gold, better banking, a more liquid currency, and the issue of more paper money in the form of national bank notes. Another law, known as the Thomas Amendment of May 12, 1933, permitted greenback paper money expansion and the acquisition of more silver. These laws were followed by the gold clause act, voted June 5, 1933, which rendered invalid the use of the gold clause in certain types of contracts. In the meantime the Reconstruction Finance Corporation was continuing its loans to banks which were made stronger by the acquisition of new funds.

The Banking Act of 1933, voted on June 16, constituted an important piece of monetary legislation. This act provided for stronger control of the banking system and for a wider distribution of the benefits of the

Federal Reserve System. The law attempted, further, to improve the administration of the banks and to enlarge the open market operations of the Federal Reserve Board. It gave us the Federal Deposit Insurance Corporation, rendered more liquid the credit of member banks, and attempted to divorce speculation from banking operations. This legislation was followed by the Emprgency Farm Mortgage Act of 1933 and the Farm Credit Act of 1933 which provided means of refinancing farm mortgages, established both the Central Bank for Cooperatives and the Production Credit Corporations, and revised the Farm Credit Administration. This was followed by the crop loan amendments of February and March, 1934. The Home Owners' Loan Corporation was founded also in that year to provide credit for home owners.

Title to all gold was vested in the United States and it was determined that no currency was to be redeemed in gold except gold certificates owned by the Federal Reserve Banks. Further, all gold coinage was stopped and the gold coins in the Treasury were melted down into bars. The Secretary of the Treasury was authorized to buy and sell gold, deal in foreign exchange, and was given a two billion dollar stabilization fund obtained from the "profit" realized by the devaluation of the gold dollar.

On January 31, 1934, the weight of the gold dollar was further reduced to 15 5/21 gr. of gold, 9/10ths fine, fixing its value at 59 percent of the former standard. Further acts, executive orders, and proclamations provided for the coinage of more silver, the printing of additional silver certificates, and it was finally decided that, of the total monetary stock of the United States, at least 25 percent should consist of silver. The traffic in silver was subjected to regulation similar to that controlling the traffic in gold. Another law which deserves mention here was the Securities Exchange Commission Act. Insofar as there is a tie-up between banks and securities trading, one cannot improve banking without regulating stock exchange operations as well.

On August 23 the Banking Act of 1935 became law. This Act represents the most fundamental revision of the Federal Reserve Act since its adoption. Among the improvements in our banking system which this Act obtains may be mentioned; the concentration of responsibility for a national credit policy with the governing board of the Federal Reserve system, a new and broader open market operations policy, improved rules governing discount rates and reserve requirements, wider lending powers, a liberalization of the provisions under which National Banks are permitted to make real estate loans. The Act reorganized the Federal Reserve Board and made important administrative changes in the Reserve Banks themselves. It clarified much banking practice which had been obscured in the past and constitutes, on the whole, a step forward in the long fight for a more centralized and efficient control over the banking system.

Why were all these laws, executive orders, and proclamations necessary? We would have come out of the depression with a changed monetary and banking system whether we voted laws or not. They would have changed by the force of circumstances. The point at issue was this: Were we going to allow these things to change by fortuitous circumstances or were we going to regulate and guide the changes? The Government wisely decided to guide the process. The banking system operated until the depression came, when the defects stood out in relief. Its most important weakness was the credit system

which was too frequently managed for private profit without proper safeguards of the public interest resulting in the use of much credit for speculation rather than for production. It was evident that we had an unequal distribution of credit facilities and were running the risk of losing our gold supply. Further, it was felt that the price level was too low to permit the satisfactory operation of agriculture, industry, and trade.

What are the consequences of the new legislation? First let us make this point: Our present practice is in keeping with our past monetary policy. We have not planned for money any more than we have planned for anything else, having been satisfied to meet situations as they arose. Further, we have had, during the last few years, an inflationary monetary policy. We have attempted to issue more money, to make credit more readily available, and to raise prices and lower exchange rates by devaluating the gold dollar. These measures have not, to an appreciable extent, resulted in the phenomena commonly associated with inflation. Prices have hot shown the expected increase. Speculation has not developed, and there has been no great export boom. Currency inflation, like a vaccination, may or may not "take". Those who were responsible for the devaluation of the dollar hoped, I believe, that prices would rise materially. They were, in the main, disappointed because economic life, especially the purchasing power of the public, was so depressed that it could not sustain a marked inflationary movement. When economic life resumes its normal tempo there is the possibility that these measures may bring some inflationary results and that we will be faced then with a rapid rise in prices.

It would appear that we are committed to some form of managed money comprising increased supervision and control over the system. The long struggle which we have had to obtain greater control has been aided by this depression legislation. Some critics have said that we have always had control and supervision over money exercised by bankers and that the new legislation merely transferred the control from the bankers to politicians. They use the word "politician" in a derogatory sense as a means of casting discredit on the new control. It is doubtless true that bankers have controlled credit in the past and that the new legislation does provide for control by "politicians". This may be a good thing nevertheless, because, whatever we may say about the politician, he is at least responsible to people and the banker is responsible only to his own conscience.

One of the potential results of this legislation lies in a better distribution of money. The credit system has been broadened in favor of the small man and has been made more helpful to farmers and the owners of small homes. Monetary instability was accentuated by the changes, and again I emphasize this point: That monetary instability has long been the American policy. Those who talk about stable money talk about something we have seldom had in this country, something the people as a whole have never wanted. Stable money is after all inadvisable in a changing economic life. The present monetary solutions have been compromise measures in keeping, again, with the historical American policy. We have been experimenting with money and will doubtless continue to do so.

It is difficult to forecast what will happen to our monetary policy in the near future. Should we adopt a gold, gold bullion, or gold exchange standard? I would advise the abandonment of the usual gold standard and the adoption of a form of the gold exchange standard which should render it easier to manage money in the interests of the public. Under the

gold exchange standard we could use gold for purposes of foreign trade and paper for domestic circulation. The volume and nature of the domestic paper money would be subject to control and the institution of money made to serve the interests of the people and brought to vary with the exigencies of a changing economic life.

THE LESSONS OF GERMAN EXPERIENCE WITH UNEMPLOYMENT RELIEF

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German experience in the field of unemployment relief is of special interest to America for several reasons. In the first place, Germany has experimented with a great variety of methods of dealing with the unemployed, and thus presents the opportunity for studying not merely the effectiveness of any one method, but also the problems of integrating several simultaneously operating systems. In the second place, Germany is a federal country and the German experience, therefore, throws more light on the problems to be faced when the government attempts to provide security for unemployed people than does the much more familiar English experience. Finally, unemployment in Germany has been long continued and severe, and the particularly difficult problem of what to do with the more or less permanently unemployed has been present in an acute form. From the German experience, we may thus hope for some light on what we should attempt in handling our own chronic unemployment problem.

First of all, however, it is well to remind ourselves of the basic problems presented by the attempt to provide security to those who are unemployed. There are two fundamental questions to be answered. They are simple to state, but, unfortunately, extremely difficult to answer. The first is to decide what kinds of benefits and how much of any given type of benefit to give to unemployed people, and under what conditions those benefits are to be made available to them. This is principally a question of social values. How generous do the rest of us want to be to the people who have no income because they can find no job and who are dependent for their purchasing power on what they can earn? In what form are we to give the relief? Shall we give it in a cash payment that provides nothing more than maintenance? Shall we give it in the form of jobs? If the latter, are those to be jobs similar to the ordinary jobs given by the private employer, or shall they be subject to certain special conditions? If there is to be more than one type of benefit existing simultaneously and if people are to be selected by reference to more than one criterion, how is the line to be drawn between those different types of benefits and different groups of people who may get them? Are we to pick out certain people for preferential treatment because they have paid contributions to an unemployment insurance plan in the past, or are we to limit this sedurity in some other way?

Nor is this problem merely one of social generosity. It raises also the question of how far we can give certain kinds of benefits without unduly interfering with the operation of our economic system. Our present system is operated on the principle of inducements, or to use an uglier word, coercion, as a method of getting people to cooperate in production. Those who own no property can secure income only if they can

sell their labor. They can find a market for their labor only if they are prepared to accept the wages that the market offers. If they stand out for unreasonably high wages, they are subject to pressure, in the form of absence of income, to reduce their asking prices. Under such a system, any guarantee of income during unemployment enables people to hold out longer.

To admit that in guaranteeing income to the unemployed society is running a risk of postponing desirable price readjustments is not to say that such a guarantee is a bad thing. Wage reductions are by no means always the only remedy for unemployment. And many people feel that the suffering involved in an attempt to apply the principle of coercion in an extreme form is too high a price to pay for 100 percent efficiency of adjustment in our economic order. The real question, therefore, is not whether we shall run the risk at all, but the <u>extent</u> to which we are prepared to do so.

The problem of selecting the right type and amount and duration of benefits is thus the first problem of an unemployment relief system. The second basic problem is financial. How is the money to be raised? Specifically, how is the cost to be distributed between different social classes and different governmental units? If the federal government is to contribute out of general taxation, at what point in the program can that contribution most usefully be made?

That again is partly a matter of social judgments. If it is held desirable that certain kinds of people should pay for their own security, the unemployment relief system will be financed by taxes expected to fall on these people. On the other hand, it is partly a matter of the expected economic consequences of different kinds of taxes. A tax on payrolls may be approved because of its anticipated effects on employers' stabilizing activities, or disapproved because of its anticipated effect upon business enterprise.

These two problems, concerning the form and conditions of benefit, and the methods of financing, face any attempt to deal in a logical way with the problem of unemployment relief. It is well to note that the two questions are not absolutely distinct. If preferential benefits or unemployment insurance are to be limited to people who have paid taxes in the past (on the ground that people should only get what they have paid for in whole or in part) the financial problem is at least in part automatically answered. But they are not absolutely tied together, and one of the points I shall make is that they should not be so regarded.

Now, may I turn to the situation in Germany between 1927 when the main lines of the existing system were laid down, and 1933? Beyond that date it becomes a little difficult to be either objective or scientific about what has happened. In the period since the war, Germany has experienced a very severe unemployment problem, The unemployed rose to three million in 1930, four million in 1931, five and five-tenths millions in 1932, and over six millions in the spring of 1932 and again in the spring of 1933. With a working population of around nineteen to twenty millions, such severe unemployment presents a problem of maintenance that would have taxed the resources of any community.

The German method has been to develop three kinds of unemployment relief. First of all, an unemployment insurance system was instituted in 1927, somewhat similar to the kind of unemployment insurance or compensation visualized in the Social Security Act. It is a method whereby employers and workers pay contributions to a

central fund and, when they are unemployed, workers who have been paying contributions for a certain period in the past become entitled to unemployment benefits. Such unemployment relief differs from other types because in order to get it, people do not have to pass a means test, proving that they are in need. They obtain it merely by reference to the fact that they contributed in the past. But they obtain it only for a limited period of time. The benefits depended upon the wages that had been earned in the past. Workers were divided into a number of wage groups. Originally there were eleven groups of people and for each of these groups a different rate of benefit was fixed. The plan was to be financed entirely by contributions from employers and workers.

Now it is obvious that such a system will not cover everybody. It leaves out of account, first of all, all the people who are not covered by the insurance plan. In Germany, the coverage of the insurance system was very wide. It originally included practically all wage earners earning less than a certain sum of money which brought in all the manual and most of the non-manual wage earners. But even so, the coverage was not 100 percent, and in 1933 agricultural workers and domestic servants were cut out.

The second group falling outside the insurance system were the people who had exhausted their right to insurance benefits. It is of the essence of the social insurance means of providing these benefits that a limit is fixed to the obligations of the insurance fund. In Germany insurance benefits were originally paid for twenty-six and, subsequently, for twenty weeks. Those out of work beyond this period had to be cared for in some other way. One further group of people was excluded from insurance; namely, the people who had been working in the past in insurable trades, but not for a long enough period of time to have accumulated the necessary insurance contributions. 1/ In a long period of chronic unemployment, the number of people who can satisfy the so-called contributory qualification tends steadily to decline. Finally, in a system of this nature where the amount of the benefit is adjusted to the wages that people have received in the past, workers who have large families and who are in the lower wage classes will not be able to live on 50 or 70 percent of their earnings, which is all that they were allowed under the unemployment insurance plan. There was, thus, need for a supplementary relief system.

The German solution was to build up a second method of dealing with the unemployed, the so-called emergency relief system, under which people were cared for when they had exhausted their insurance benefit. It was paid under different conditions and financed by different principles. People could only get Emergency benefit if they were in need, and certain kinds of workers such as agricultural workers and a few other groups were not permitted to claim it. The money for Emergency benefit was put up by the federal government to the extent of four-fifths and by the local municipal authorities to the extent of one-fifth. Later, the

1/ All insurance plans recognize a worker's claim to be an insured person only if he has been making contributions for not less than a given number of weeks in a previous defined period.

local authorities were entirely relieved of their responsibility.

Even so, some people were left out because Emergency benefit also was paid for a limited period. In Germany, the residual system was the traditional means of relief of destitute people; namely, the public welfare system. This, too, had its own conditions for benefit, and it applied a more stringent means test than that of Emergency Relief. It was financed originally entirely by the local authorities with some State aid, but subsequently the federal government participated also.

Such was the German system after 1927. Originally it was quite logically conceived: a first line of defense paying benefits as a right to selected groups; a second line of defense, financed very largely by the federal government, paying benefits to insured workers in need, and only the people who were not cared for by either of these systems would call on the local authorities for assistance under the public welfare system.

Does this structure provide a model that we should follow? How far did it reveal certain weaknesses? If I talk in the main about the weaknesses rather than the achievements, it is because the achievements in that system were of a very broad general nature whereas the weaknesses reveal certain specific problems which we should do well to bear in mind when we are considering America's tremendous relief problem. The achievement of the system was the fact that in spite of the tremendous unemployment problem, Germany experienced up to 1933 no serious decline in the general level of health of the population. It may be objected that this is a very low standard to adopt. I do not think it is when the nature of the country we are considering is recalled. It is true that the standard of living of the unemployed was not high; towards the end of the period it was miserably low, but so also was the general level of wages. The standards of unemployment relief could not have been raised very much as that would have reduced to a dangerous degree the differential between wages and relief. But careful investigations by a number of doctors suggest that at any rate until the end of 1932 Germany had come through that tremendous period of depression with a surprisingly small impairment of the general public health. That is the more striking when it is remembered that the children whom the doctors had been studying were the children of the war generation who had no time to recover from the effects of the general war situation, and the blockade, before they experienced the inflation period, and but a few years of moderate prosperity elapsed before the present period of severe unemployment. Thus, the heavy unemployment occurred at the end of practically fifteen years of intense economic depression and impairment of the necessities of life.

You do not find, in looking through the records in Germany, tales of personal suffering and degradation such as we discover in the Senate hearings on unemployment in this country in 1931 and 1932, or in the various State Commissions' reports on unemployment before the Federal government took a hand in the matter. We must never forget this achievement however much we may criticize the details of the German system.

What conclusions seem to emerge from a study of the unemployment relief methods adopted in Germany? First of all, I suggest, the inevitability of an integrated approach

to the problem of unemployment relief, and the undesirability of picking out one group of the unemployed for special treatment and concentrating on the insurance system that is to take care of them to the exclusion of the problem of the residual unemployed. Secondly, the German experience points to the inevitability of federal participation to a very large degree in the financing of an integrated unemployment relief system. A third lesson is the inadequacy of a program which thinks merely in terms of maintenance as the vital problem of unemployment relief without paying attention also to the necessity of giving people status in the community, of giving them something to do as well as giving them something to keep them barely alive. But on the other hand, the German experience suggests some of the very real difficulties of attempting to solve the problem by a large works program. I propose to develop each of these points.

You will recall that the German plan built around the unemployment insurance system as the first line of defense. The insurance system was to be financed on a self-sustaining basis, solely out of the yield of wage and payroll taxes with no permanent contribution from general taxation. If at the same time there is rigid adherence to the view that the program must be "actuarially sound" i.e. that income must balance out-go, the role that such a system can play in the total relief picture will depend on the amount of money that can be thus collected from employers and workers. And it is extremely improbable that this role will exactly coincide with the scope of an insurance system which one would arrive at if one considered the matter from the angle of benefits and asked instead what was the proper part to be played in a total relief set-up by benefits of any given type. Certainly there was no such coincidence in Germany.

Contributions to the insurance fund, which had begun at 3 percent were finally increased to 6 percent, shared between employers and workers. It was believed impossible to collect more in view of the other taxes paid by employers and workers to finance other social insurance programs. At first the Federal government loaned money to the Fund in the belief that the crisis was temporary but after 1930 the loans were cancelled and thereafter the insurance system had to stand on its own feet. With growing unemployment a balance of the fund was then achieved by cutting down expenditure. Benefits were reduced in amount and duration, conditions for receipt were tightened, certain classes of workers were excluded. The only result was to throw more and more people on to the other parts of the relief system until in the fall of 1932 the insurance system was providing for less than 12 percent of all the unemployed, whereas in 1929 it had been providing for 74.2 percent.

But, unfortunately, much the same thing happened in regard to the emergency system, which you will recall had been introduced in 1927 in the hope of removing from the local authorities the residual relief burden. This emergency system was financed to the extent of four-fifths by the federal government. In practice, however, the part which it played in the total relief situation was limited because of the unwillingness of the federal government to shoulder so heavy a relief burden. In consequence, it limited the classes of people who could obtain emergency relief. It first limited its payment to certain employments and to specified areas in Germany, and, above all, it fixed a limit to the dura-

tion for which this kind of unemployment relief could be paid. After October 1931, the total duration of Insurance and Emergency Relief was limited to fifty-eight weeks. At first sight this seems a long period of guaranteed benefit, but one of the surprising facts that emerges from a study of the German experience is that in a long-continued depression, even so generous a benefit period fails to take care of the needs of a large proportion of the unemployed. With an intensifying depression, an ever larger proportion of the total unemployed tends to become composed of persons who are out of work for several years. This is, of course, partly because the longer a man is out of work, the less is his chance of securing reemployment. Employers prefer to take on men who are still familiar with the habits of work and who have not lost their skills.

Because, therefore, of the federal government's unwillingness to carry the responsibility of maintaining the long-period unemployed on Emergency Relief, more and more of these people had to turn to the public welfare system for maintenance. At the end of 1931 the local authorities were thus carrying almost half, and in later years, more than half of the burden of maintaining all the unemployed in Germany.

This was a highly unsatisfactory arrangement. It was unsatisfactory because the taxing and borrowing powers of the local authorities were by no means as elastic and as appropriate for depression financing as those of the Federal government. Thus, in a period of depresdion, an increasing burden fell upon a fiscal system that was peculiarly ill-equipped to carry it, and the local authorities were compelled to exhaust every possible tax resource, and these were very limited. They had no control over the rates of the income tax, which were controlled by the Reich and a proportion only of the tax was handed over to the local authorities. The latter were limited to taxes on industry, taxes on local property and taxes on beer and other luxury expenditures. But, in a period of depression, these are not very productive taxes, especially in just those areas where unemployment is most severe. The industry taxes had also a depressing effect on general business enterprise, and the yield fell far short of what was required to provide relief for millions of people. So the local authorities did what all governments do when faced with a financial crisis. They tried to borrow. Their ordinary borrowing powers were limited, and so they borrowed in all kinds of ways; from their school teachers and their employees by not paying their salaries, from contractors by not paying bills when they fell due, from the States, because they collected certain taxes on behalf of the States and they refused to hand over the money, and from the federal government by holding back their share of the costs of Emergency Relief.

This was obviously a demoralizing fiscal situation. Local morale and responsibility may be destroyed just as effectively by driving local authorities to resort to desperate measures to finance an impossible burden, as by removing from them any financial responsibility at all. In the end, of course, economic pressure prevailed. The federal government was compelled to give financial assistance to the local authorities to save them from bankruptcy and to avoid political reactions from unemployed people whose benefits were being cut down. But because of its previous emphasis upon local responsibility for maintaining the unemployed, it found itself in a very unfortunate position.

When it tried to lay down the conditions under which the money was to be spent, it was attacked for interfering with local initiative and self-government in the field that had hitherto been reserved solely for the communes. Until 1933, when the advent of the Nazi government greatly weakened the status of the local self-governing units in every respect, the federal government was placed in a position of having to provide a large amount of the funds for an unemployment relief system in which, however, it possessed very little control over the levels of benefit and conditions under which benefit should be given. This problem has still not been completely solved.

There were also many undesirable consequences to the unemployed arising out of a three_fold system, each of which was financed on a different principle. The nature of benefits given by each of the three systems came to be determined not by reference to any rational criterion, but solely by reference to the desire of the authority financially responsible, to save money. Thus, the pressure on the local authorities led them to cut the benefit rates in those areas where unemployment was most severe. But these were precisely the areas where the need for relatively generous benefits was greatest since it would be in thesd areas that the largest proportion of long-period unemployed were to be found.

Another consequence of concentrating the costs of residual unemployment on the local authorities was to compel them to economize in other directions. It was unfortunate that the major responsibility for the subsidiary social services (local public health services, services to childred and mothers, hospital services and services in the schools) lay with the local authorities rather than with the federal government. Once again, therefore, in just those areas where the need was greatest, the pressure to economize was also at a maximum, and these services were curtailed, which, in a period of depression, should have expanded.

Moreover, the heavy burden of residual relief made the local authorities extremely unwilling to participate in any efforts made by the federal government to develop, by the offer of a subsidy, a work-creation program. In Germany as well as in other countries, initiative in developing such projects lay mainly with the local authorities, but work relief, being more expensive than other forms of relief, was avoided by them on the whole, as being something they could not afford to carry at a time when they were straining their resources to the utmost. Thus, just when a big work relief program was most needed to maintain morale, (namely at a time when the long-period unemployed reached a maximum), the nature of the threefold unemployment relief system tended to discourage its development.

Determination of the scope and nature of the benefits of each of the three systems solely by reference to the pressures on the authority responsible for financing them, in time destroyed any logical relationship between them. After 1932, a worker could very properly ask wherein lay the advantage of, and justification for, a separate insurance system. It gave him benefits as a right only for six weeks, after which he had to submit to a means test. The amount of the benefit for many wage classes was cut so much that he received less as an insurance claimant than he would have received from public

welfare, and in addition he had to pay a wage tax in order to get it.

Finally, from the administrative viewpoint, the German system after 1930 proved very unsatisfactory. Where certain types of benefit were identified with federal or local financing, the question of whether a person should be given welfare relief or emergency relief came to be a question of what benefits should be paid by the local authorities and what by the Reich. People were selected for work relief not by reference to whether they were most in need of that particular type of assistance, but largely by reference to who was responsible for financing them. Each responsible authority tried to push the unemployed on to the account of the other.

The third lesson that emerges in the German experience is the necessity of planning for an unemployment relief program that will provide people with something more than mere maintenance. To those of you who are at all familiar with the German literature, this may sound a surprising statement. You will recall the fact that the insurance system contained always a provision for giving subsidies to public and to non-profit-making private employers to encourage them to give work to unemployed workers. The money for this emergency work was drawn from the unemployment insurance fund and the payment per worker roughly equaled the money that the insurance systhem would save by not having to pay further benefits to these workers. You may further recall that in 1926, 1930, 1932 and 1933, special work-creation programs were carried through by the government in the hope of stimulating these emergency work projects and putting in operation special public works. It is also true that from 1931 onwards a special institution, the Voluntary Labor Service, was brought into being to care for young unemployed workers in a way that closely resembles our own Civilian Conservation Corps methods. Finally, from 1933 onwards, the Land Helper system, whereby young unemployed workers were placed with peasants on their farms, was introduced in order, among other things, to give employment opportunity to the young unemployed.

In spite of these many institutions and ingenious attempts to encourage their expansion, the people assisted by work relief or allied projects have at no time exceeded 20% of the total unemployed. Even that percentage was reached only in 1933 to 1934 as a result of the Nazi Work-creation program. Throughout most of the period that I am considering, the people enjoying work relief have seldom amounted to more than 10% of the total unemployed and often to very much less than that.

No observer in Germany could have failed to realize the grave weaknesses of a plan which concentrated so largely on maintenance. A large part of Hitler's initial popularity with the workers, and especially the young, was due to his understanding of the fact that the average man in the street desired employment opportunity as well as maintenance. It is significant that in 1933 his most popular slogan was, "Arbeit und Brot" (work and bread). Not a high standard of living, you will note, but emphasis on having something to do. Hitler was not alone in realizing the shortcomings of a relief program that concentrated on maintenance. From 1930 onwards, social workers, relief administrators and most of the political parties were greatly concerned with this problem. They pointed again and again

to the demoralizing effects of long-period unemployment. Workers who had nothing to do for one or more years began to feel critical of an economic order which denied them an opportunity to work and which made them feel that they had no status. The inevitable psychological reaction was to develop a hostility to the existing economic order.

In asking why, in spite of this general awareness of the problem and in spite of the existence of so many ingenious attempts to provide work, so little was in fact accomplished, we may, I think, learn something from Germany's experience of the real difficulties of a relief program that attempts to provide jobs rather than cash doles.

In the first place, it was discovered that in order to meet the needs of unemployed workers these projects must be real jobs, as workers normally understand the word. Before 1927 and again in 1933, attempts were made to develop projects for which the unemployed received a sum of money which was very little above their ordinary unemployment allowance. This arrangement was found to be very unsatisfactory. It looked to workers as if it was merely a "made work" project devised to test their willingness to work rather than to provide them with a real job. Because the jobs meant so little to them they were not afraid of slacking since the penalty of being "fired" was so slight. The public authorities for whom they worked found the enforcement of discipline very difficult for this reason. As a result, it was decided that in future, such jobs were to be made as nearly as possible like "real jobs" in the matter of conditions of work and remuneration.

In the second place, it soon became evident that this kind of relief is much more costly than one which limits itself to cash payments to unemployed workers. It is not merely that materials and supervision have to be provided, but also, as I have just pointed out, the money payment to be made to each unemployed man is necessarily greater if the objectives of the program are to be achieved. This extra cost is a real difficulty because the need for this expenditure is greatest when the country is most depressed and when there is likely to be most criticism of the government for spending money. In addition, it is obvious that if this money is to be raised by additional taxation, any good that is done by the work program may be offset by the harm to business resulting from the new taxes. Almost inevitably, therefore, a work-creation program of significant proportions in a period of depression calls for a preparedness on the part of the government to adopt a policy of monetary expansion. But such a policy was politically almost impossible for any German government after the inflation period. Again and again the proposals for a large program of this nature were abandoned because no government dared run the risk of disturbing public confidence by embarking on a monetary policy which might be interpreted as leading to inflation.

In the third place, the failure to provide anything like a work program for any significant proportion of the unemployed was certainly not attributable to a shortage of projects. From the engineering and social point of view, there were always plenty of projects that could be undertaken with great advantage to the country as a whole. The difficulty lay rather in the nature of these projects. In Germany,

as elsewhere, the work creation program had to be adapted to the conditions of a capitalistic society. The projects had to be of a nature that would not interfere with private business, but at the same time they had to be "economically valuable". In addition, in order not to weaken the sense of local responsibility, it was required that any projects undertaken should be additional to anything that would otherwise be carried out. At first, the federal government tried to develop projects through the agency of local authorities and non-profit-making organizations, but this policy was not very successful. The kinds of projects that did not compete with private enterprise and were also economically valuable were in the main those yielding a return over a long period of time, or projects which necessarily fell in the category of social luxuries (additional playgrounds, swimming pools, municipal amusements). Unfortunately, in a period of depression, it is politically difficult for a hard-pressed local authority to justify expenditures on projects of this nature. At the time when they were cutting down ordinary expenditure (reducing salaries and numbers of school teachers, librarians and social workers) it did not seem very reasonable to the local authorities to be asked to spend additional money on projects which tied up capital for a long period of time and which were, relatively speaking, luxuries. As a result of this basic difficulty, the Federal government was compelled in time to adopt much less rigid restrictions concerning the type of work that could be carried out as a work project, and in 1933, even began to pay money to the local authorities to develop as work projects certain activities which under normal circumstances they would have been expected to carry themselves as part of their regular functions.

Finally, many unexpected technical difficulties were experienced in attempting to put through a large works program. Projects of permanent value, which did not compete with existing private enterprise, are, as I have said, almost inevitably capital investment projects bringing a return over a long period of time and very frequently incapable of completion within one year. But owing to budgetary requirements the federal government was unable to make money available on more than a year-to-year basis. Thus, the local authorities and other organizations were frequently put in a position of starting a project calling for heavy expenditure over several years, with no certainty that in the following financial year, the Reichstag would vote the necessary appropriations. The result was that many of them refused to undertake such serious commitments. It was finally found necessary to set up a semi-independent corporation, the so-called Oeffa, or public works corporation, which was given entire charge of the work-creation program and had its own income, in order that it could finance these long-run projects and avoid the difficulties of uncertain yearly appropriations.

German experience also threw considerable light on the most effective type of stimulus to be adopted when the government tries to encourage a work-creation plan. It was at first thought that it would be sufficient to offer money to the local authorities in the form of loans on easy terms, but in view of the serious financial situation experienced by these authorities, to which I referred earlier in this lecture, such a

stimulus was far from adequate. The federal government finally realized that if it wanted to encourage this kind of program, it would have to be prepared to provide the greater part of the money itself, and by way of an outright subsidy rather than a repayable loan. In its attempt to put through a large work program, the German Government even experimented with subsidies to private producers, especially from 1932 onwards. Here, too, some interesting results were obtained. It was found that certain kinds of subsidies were very effective, but at the disadvantage of interfering quite considerably with the relative competitive position of other non-subsidised employers. But, it was also found that, statistically speaking, generous subsidies to private employers were more effective than subsidies to public authorities. This was especially the case when the subsidies were paid to people such as house owners for repairs and rebuilding and other persons employing labor for making products that were to be enjoyed by the owner himself rather than sold for profit on the open market.

If we now consider the German experience as a whole, it is, I think, not difficult to see that certain rather broad lessons of importance to us in America can be drawn. In the first place when we are considering our relief problem as a whole, it looks as if the first step should be to decide the questions connected with the form of benefits and conditions for receiving them. We must determine how generous we intend to be to those who are out of employment, and if we are to give more than one kind of benefit, we must try to make these available to different classes of unemployed people on some logically defensible basis. If we propose to make the right to certain kinds of benefits dependent on the past payment of contributions, we must make sure that such benefits are definitely superior to those that can be obtained by workers who have paid no contributions. If we discover that benefits in the form of jobs are more costly and raise more difficult administrative problems, we should do well to limit the opportunity to such benefits to those cases where they will do most good; in other words, to the long-period unemployed. In making our broad decision as to how far we will embark on any work program at all, we must do so in the light of the very real problems to be solved and costs to be borne as a result of a program of this nature. We must be prepared to pay people on these jobs something approximating ordinary wages and to face the difficulties that are inevitably raised in connedtion with private employers on the one hand and labor on the other, who have their different ideas as to what wages the government ought to pay. We cannot, at one and the same time, say that we will adopt a generous work program and interfere not at all with the field normally reserved for private initiative. If we wish to use the local authorities to organize and develop these projects, the federal government must be prepared to give money to these authorities under much less stringent conditions concerning types of work that they may put in hand.

When we have made our decision concerning the kinds of benefit we can afford to give and the basis on which they are to be made available to different classes of the unemployed, we must consider the detailed question of finance. It follows from what I have said that this is a question of distribution of the cost rather than of totals,

for the answer to the first question (the types of benefits) and will necessarily give us the total sum of money that we have to raise. The problem of financing is one of how this total cost is to be distributed among different sections of the community and among different governmental authorities. This is partly a matter of social adjustments and partly of common sense. Our social values will lead us to decide whether more or less of the burden should be carried by wage earners or by large income receivers or by other groups in the community and when we have decided this, we must select the proper taxes accordingly. Common sense suggests that it is useless to place the responsibility for financing a heavy relief burden on the authorities whose taxing and borrowing powers are limited. If we do not wish to interfere with the existing distribution of taxing and borrowing powers between the federal government and the States it follows that we must develop a financial system in which the heaviest burden of relief financing will fall upon the federal government, whose taxing and borrowing powers are greatest.

DISCUSSION

Chairman: We have as one of our panel today Dr. W. J. Couper, who is with the Unemployment Compensation Section of the Social Security Commission at the present time.

Question: Mr. Chairman, it has been a sad experience to sit here listening to Mrs. Burns' admirable exposition of the lessons of the German experience, while realizing how few steps we have yet taken in the United States to avoid those same difficulties, and my first question is, therefore, directed to Mrs. Burns not really for the purpose of getting any information but just in the hope that a snappy and informative answer will cheer my drooping spirits. Is it not true that despite the very serious economic situation that Germany faced, and despite the general reaction of the liberal tendencies of the Breuning and Hitler Governments, that there has not yet been any tendency to frankly disavow the principle of unemployment insurance?
Answer: I will make that answer very snappy, but I cannot quite say yes or no, because of the form in which the question was put. The answer is that there has not been any attempt to abolish the system of giving people unemployment benefits as a right. Since Hitler has been in power, in a number of ways, the insurance system has even been extended and made somewhat more liberal than it was.

May I perhaps, at the risk of not being snappy, add that in Germany there had been until 1933 very strong pressure to abolish the insurance principle. I was told when I was there in the fall of 1933, that a bill was actually prepared completely to abolish the insurance system, and the system was saved at that time only because Hitler himself said that it would be impossible for his regime to take away from the people something that they themselves felt had so greatly improved their position and enabled them to come through the depression.
Question: Much cheered, I arise for the second question. Your second part related to the necessity of Federal participation in any scheme. Is that criterion suffi-

ciently complied with by our present Federal attempts at work relief programs through the WPA and other programs if they were otherwise satisfactory? If I can make the question double-barreled, is it fair to criticize the present Social Security Act on the grounds that a large share of the necessary financing under it should come directly from the Federal Government and through income taxes?

Answer: It really comes to asking whether the work relief program, as it has been taken over by the Federal Government, represents an adequate Federal contribution to the whole program. Ishould say that as the definitions are drawn at the present time, no. It does not seem to me that if the Federal Government confines itself to aiding the 3.5 millions who are supposed to represent the millions of employables, it will have made an adequate contribution. For one thing, if people get on relief that claims to be "a real job", they do not fall out of it as quickly as they fall out of the ordinary relief system. Meanwhile there is a growing problem of new employable people becoming unemployed - thus the number of employables "unemployed" is likely to be considerably in excess of 3.5 millions, and the surplus will presumably have to be cared for by the State and local authorities. It would be too good to be true that the line between the unemployed who are employable and the unemployed who are technically unemployable should at all times be identical with the line between the elasticity of the tax resources of the Federal Government and the elasticity of the taxes and borrowing resources of the State and local governments.

With regard to the second question, I take it you are referring to the unemployment compensation part of the Act. I would criticize the unemployment compensation sections of the Social Security program from the point of view of how it leads into an integrated system. I would criticize it for throwing the decision as to how far there is to be any first line of defense at all into the hands of the States, which means that in many cases there will be no unemployment compensation. So far there are nine States and the District of Columbia which have passed laws of that kind. It remains to be seen how many others will follow suit.

I would also criticize the Social Security Act indirectly on the ground of non-general tax participation, not necessarily Federal but <u>general</u> tax participation. Too much emphasis has been placed throughout on the self-sustaining theory. Of course, it is true that it is up to the States to do what they want, but the chances are that most of the States will limit themselves to the taxes they impose on employers and will contribute little from general taxation.

The amount of the benefit to be paid in this first line of defense is likely to be limited to about fifteen weeks at most, and in some cases only 12. We shall not get the best use out of this first line of defense if we use it only for fifteen weeks. We build up this elaborate machinery for getting records in order to sort the sheep from the goats, and to see that we don't pay people more than they are fairly entitled to, and to ensure that claimants

are genuinely workers. If in the end we use this system to pay benefits for only twelve or fifteen weeks, we will make very little use of this administrative overhead. A rich country can afford to pay workers these preferential benefits without pressure, for somewhat more than fifteen weeks. And I also think to draw the line at fifteen weeks leaves an undesirably large residual problem. But the residual problem cannot be greatly reduced without extending the duration of compensation benefits - And this in turn is impossible without some provision for a Federal or a State contribution from general taxation. In that sense I would criticize the act, but I don't know whether that is the kind of answer that Dr. Couper wants.

Question: There are so many other questions; let me impose this one. Would you imply that you would unify into one single authority the administration of the different types of benefits required to arrive at a satisfactory system in an unemployment relief plan?

Answer: No, we have to break up the problem of administration. Many different functions are involved. One type of authority has to make one group of decisions which involve matters of policy. I refer to such questions as the part that is to be played in the complete, integrated system by the different kinds of benefits and the principles on which the cost is to be distributed. Such decisions should be made by a single authority; which does not, however, have to be a Government Department; it might be a board representing the interests involved. When you have decided on the part that is to be played by the different types of benefits, and when you have decided on your methods of financing, then the day-to-day administration of the unemployment insurance work-relief system must be considered. This should be done by an entirely different type of authority.

Since a considerable measure of Federal participation will be inevitable, and since there is a great deal to be said for having uniformity of protection, at least for a period of time, in order not to interfere with the mobility of labor as between States, my own preference is ultimately for a Federal first line of defense. This could be administered by the Federal Government or by local officers of the Federal Government, because administratively it does not involve much discretion.

That is the great argument in favor of unemployment compensation. It is so relatively simple to administer. Workers can be treated as categories, not as individuals. Decisions concerning the exercise of pressure on individuals to take jobs other than those to which they have been accustomed, or at less than prevailing rates, are removed from the realm of administrative discretion in most unemployment compensation plans. There is also no individual means test.

The second line of defense which may take the form of straight relief or of work relief, will call for a much greater degree of local knowledge. Selection of projects and workers to be employed on them should largely be directed by local authorities, because it is desirable to have local interest and participation in these matters. But quite a different type of authority would have to handle the decision as to how large a part of the total relief provision would be played by a work program. It would be made by a body able to consider the general economic circumstances of the country, and capable of deciding,

for example, whether it is desirable to have a big credit expansion in the hope of encouraging spending. It might also have to decide broadly in what parts of the country a work program could most usefully be carried out. One can only approach Dr. Couper's question by asking what types of functions would have to be carried out, and what types of decisions are involved.

Chairman: The second member of our panel has had some experience abroad as Federal Trade Commissioner of the American Embassies in Paris, Berlin and Brussels. Mr. Thomas Butts.

Mr. Butts: As I understand my role in this discussion, I may critically examine what has just been said or, constructively, divert the important subject under discussion to a new channel of thought. I want to do both and in addition, do some viewing-with-alarm. First of all, let me restate the question: "What can America Learn from German Experience in Handling Chronic Unemployment". If we were looking back over the past five years or so it would be perfectly plain that we have learned a great deal from Germany, as well as from some other European countries, in the matter of handling unemployment. But as Dr. Burns has confined her remarks to the sociological and economic aspects of the question and has put it in the present tense, it is equally plain, I think, that the answer is we have nothing more, or very little more, to learn, within those limits, from Germany, or from any other country for that matter. Let me explain. Our present social security legislation, which has been the law of the land since last August, was evolved only after the most searching inquiry by both the Senate and House Committee which conducted the hearings on the bill. Most of the experts who testified invariably directed the attention of the Committees to the fact that the only basis or background on which we could rely for the construction of the comprehensive compulsory unemployment compensation law under consideration, was the experience of countries such as England, Germany and some others where such legislation had been in force for a number of years. Although our Federal unemployment compensation law and its complementary state laws, already enacted, do not fit exactly the pattern of European experience, still, they reflect throughout the fact that Congress and the State legislatures were guided almost wholly by what has been accomplished in Germany and elsewhere. What basic changes there are can be traced to the requirements of our unique Federal-State form of government.

England from 1911, Austria from 1920, Germany from only 1927, as well as others, charted the way through this highly complex social problem and, as I have said, we made use of their extensive experience to our enormous benefit and the result is that we have made what is pretty generally admitted to be an excellent beginning. The original English law of 1911 which was written without the benefit of any previous experience was amended 37 times in the twenty years up to 1931. The Austrian law was amended 20 times in the 11 years between 1920 and 1931. Parenthetically let me say that those figures are taken from a study of European systems made by the Metropolitan Life Insurance Company to which I will refer later on. Does not such frequent change indicate the complexity of the problems involved and the extent to which we have benefited by the experiments of other

countries? Therefore, is not all that just so much water over the dam? We have taken our lesson from Germany and the others; we have benefited from it but from now on we must necessarily solve the peculiar American problems which will arise in the light of American customs, mentality and local conditions. I think it would be dangerous, or in any case useless, to believe that we can learn much more from Europe in this matter. So far as we are concerned the die is cast and we must now depend on our own resources. That is why I maintain we have nothing more, or very little more, to learn from German handling of chronic unemployment from the sociological and economic points of view, which alone have been considered by Dr. Burns.

In a more constructive sense let me direct your attention to an angle of the problem to which an appalling lack of attention has been paid. I refer to the purely administrative problems at the present moment confronting the seven States and the District of Columbia where unemployment compensation laws are now operative. It is a fundamental of the Federal law that the actual administration of the State unemployment compensation laws is left largely to the discretion of each State and to the District of Columbia. I am informed that there is a model law for the guidance of the various States in shaping their legislation and that is a very excellent and necessary thing. But as the States, each in turn, adopt their individual laws, they are literally in the very embarrassing position of not knowing how to administer them. It would be very useful if it were possible, to devise a model administrative system to complete the job. Each of the seven States referred to and the District are on their own, administratively, and some of them are not yet aware of the complexity of the problems before them. Problems which will arise from such details as the migration of seasonal workers from State to State will be enormously complicated by the absence of administrative uniformity and I am very fearful that the very idea of unemployment compensation will be discredited in some States if they are not guided in their handling of basic considerations as, for instance, the recognition of unemployment compensation as a "right". Iwill come back to that later.

By the unsolved administrative problems I mean particularly the problem of creating the machinery which serves as the vehicle for the administration of the law - the problem of designing the many forms which are the perfect reflection, in a practical sense, of the administrative policy. All of that apparently must be left to the individual judgment of 49 administrative units. Every solution will be different and will no doubt depend largely upon expediency in each case, to the detriment of any long-range, enlightened policy. In 1933, the Metropolitan Life Insurance Company, foreseeing our present unemployment compensation legislation and the very administrative problem I am discussing, sent a commission to Europe for the purpose of studying the various systems from the administrative standpoint. The specific purpose was to aid the various States in this country to construct their administrative systems, when the need arose, with the benefit of European experience to go by. One valuable result of the survey was that it was found that the European systems, whether voluntary or compulsory, were surprisingly alike in construction - that they were capable

of mechanical breakdown and comparison. In the following year, 1934, the National Industrial Counselors, inspired by the Social Science Research Council, which no doubt recognized the inadequacy of existing material, published the first of what was announced as a series of books on the administrative systems of the principal European countries. The stated purpose of the series was similar to that which inspired the Metropolitan Life Insurance Company the year before and which I referred to a moment ago. The first book, on the English system, was an exceptionally good job and with another, "The British Attack on Unemployment" by Hill and Lubin, we have two searching word-descriptions of the English system. Sometime later appeared the second of the National Industrial Counselors series - that on the German system. Since then the series seems to have been discontinued and at a time when it is most needed. I suspect the reason is that the Social Science Research Council has found that a mere word-description or, in other words, the scope of a book, cannot suffice to convey a true and understandable picture of an elaborate administrative set-up. The need can be met only by a carefully catalogued breakdown of administrative machinery, exhibited carefully, annotated and arranged in chart form. It will surprise many to learn that the English system is built up around 187 different forms; the German system around 261 different forms. That our States will require much fewer, I do not doubt, if only because we will use more mechanical devices. Nevertheless, the fact remains that the devising of the individual State's administrative policy and the structure which gives it form and substance is a huge and difficult job as things are now. The States of New York and Wisconsin have thus far been forced to use forms improvised and copyrighted by a private firm, solely interested in marketing its products. I was a witness to the collapse of the administration of the French Social Security law when it went into effect in June 1930. A year later the inauguration of the Spanish law was postponed three months because the administrative machinery was not perfected. Clearly, the problem is complex. The matter from here on becomes too technical to interest this meeting. It is not my function, nor my purpose, to do more than direct thought to the problem.

I will conclude by completing my reference to the possible discrediting of the idea of unemployment compensation in some States if care is not taken to preserve the very basis upon which the law is built--namely, the granting of such compensation as a "right" and not to permit it to be tainted, even remotely, as charity, a conditional grant or a gift. The expert testimony before the Congressional Committees and the very spirit of Title 9 of the Social Security Act, both stress that payments made as compensation for loss of work, under certain conditions, is as much a "fight" as the payment of an ordinary life insurance policy upon the death of the policy hold_er and that the present unavoidable lack of administrative uniformity and the absence of State guidance will lead to trouble multiplied by 49 is well illustrated right here in Washington. The recently published regulations announced by the District Commissioners for the payment of the employers' excise

tax on payrolls of eight or more, permit employers to keep their records in any form they desire. The sole stipulation is that they be "readable". Another provision permits the employer to omit the names of his employees when paying the tax. Only the gross payroll figure need be stated. Hence the District itself has no record of the individual worker's "right" to receive unemployment compensation should the need arise. It may happen that the worker in some rare cases may be dependent upon the good will of his former employer who, conceivably, may lose his payroll records or who may be so ill disposed toward his ex-employee as actually to falsify his pay record on the "separation" sheet reporting the termination of the job. Simplification of records has been achieved and recourse is possible. But what is the cost? Those who view this legislation as a huge step forward in the achievement of security for the underprivileged suffering a loss of work and income for a reason beyond their power to control - and that is how this law is sincerely welcomed by most people - those will be dismayed that workers may thus be placed at the mercy of an employer, at the expense of his (the worker's) incontrovertible "right".

What we can learn from German experience in handling chronic unemployment - finally to answer the question - is that we can yet profit from their administrative experience, andfrom English, Austrian, Italian, Swiss and French administrative experience, just as we have already profited by their legislative experience. When viewed as a practical problem, in the light of what has already been attempted and accomplished, the job is a simple one to lay out.

Question: When an employer has paid premiums, is it possible, when he is out of work, for him to apply for funds of compensation?
Dr. Burns: The answer is "No". Benefits are solely for workers.
Question: If, as we are occasionally told, all the sciences fail in a storm, what would be the effect of an insurance compensation, or an insurance plan such as this in a depression such as the one we are still trying to get out of? Woudn't the thing break down after 58 weeks or whatever period is given and be of no further force and effect in a three or four-year period of depression?
Answer: I am not quite sure from what you said, whether you mean the system breaks down because there are no funds available or whether you mean to suggest that any plan which strives to fix a limit to a certain number of weeks of benefits is unsatisfactory.
Question: Lack of funds.
Answer: It is perfectly true that if you say "We will limit ourselves to certain sources of taxation and we will accumulate a reserve before-hand, we will only pay benefits to the extent that the reserve and current taxes are adequate", a very long continued depression will throw your fund into a deficit. You can do one of two things: You can either do what the Germans finally tried to do - say, "Well, whatever happens we won't exceed our income and we won't pay people any more of these kinds of benefits", but then you will have some other kinds of benefits which you have to finance out of general taxation or general government borrowing. Or, you can do as you originally did in Great Britain, or in Germany until 1930, say "This thing can't last another year and so we will allow the fund

to borrow, and since all economic theory has told us in the past that these things are cycles and not straight lines going up and down, sooner or later, the tide will turn and there will be a period when we will collect more than we pay out, and we can pay ourselves back."

If there were a forecastable "normal" trade cycle, it would be (apart from interest charges) immaterial whether you started your plan at the bottom of the depression and borrowed, or whether you started it at the top of a boom and accumulated reserves. If your calculation had been correct, then you would always have a balance. But the practical difficulties are two-fold: Firstly, it looks as though we cannot any longer say with confidence that the movement is a purely cyclical one. Secondly, in spite of its good words, no government seems to be willing to go on lending money in the hope that sooner or later there will be an upward swing. After a time, the taxpayers begin to grumble, because they say, "This is called insurance, but look at the size of the deficit! How can we ever hope to have such a trade revival that we will pay in more than enough to cover the insurance debt?"

I should prefer to decide first of all on the conditions for benefit and the part each type is to play inthe program. There is much to be said for raising funds, or at any rate, a substantial part of your money, by taxes from employers or workers. But we must be prepared, if that doesn't happen to be enough and you run into a depression, to put up the additional money from other sources - that may be from general taxation or possibly from borrowing.

From Floor: Inasmuch as these other Governments have had years of experience in taking care of unemployment, and inasmuch as we have already started it, it appears to me, from the talk of today, that we will have to keep it going when we have problems of this kind; in other words, that we have a problem which comes up possibly due to our system and the one which we have to face right now. Have you found any solution to the problem in the way of a cure? I mean, do you know of a method whereby there will not be that problem? Is there any solution which you have found, either abroad or here?

Dr. Burns: Well, I am sorry I have to be very pessimistic and say I have not found any solution to the problem. It looks as if on some occasions, Governmental activity directed toward encouraging spending, may get you out of your difficulty, if all you are facing is a rather severe cyclical movement. But I do not think that any government has as yet been able to devise satisfactory methods for completely eliminating unemployment that may be due to other causes.

Now, the German Government undoubtedly tried some extremely drastic remedies. From the end of 1930 to 1932, on the theory that unemployment was due to a maladjusted economic order and that prices in Germany were too high, the German Government carved through a tremendous economic program of compulsory economies - cutting wages, interest, rents, unemployment compensation, reduced practically every price you can think of in the country - an extremely courageous thing for a government to do, and tragically enough, one of the things which helped to precipitate the downfall of the Bruening Government. However upright and honest the Government

may have been in its aims in carrying through a program of that kind it could not be very popular with the population as a whole. To enforce a downward trend of prices which fails to bring about immediate results in the form of a trade revival is to court political disaster.

The Germans have also tried to some extent to adjust the problem by developing a back-to-the-land movement by persuading people to move outside the towns and settle in small subsistence homesteads. Such a program is based on the assumption that you are going to have a rather limited amount of work and that it is desirable to spread it among as many people as possible. Unfortunately the economic policies of governments often conflict with their political objectives. Even when in 1933, the Government embarked on a much-needed, bold expansion program, its economic effect was spoiled by a foreign policy which involved the cutting off of imports and the attempt to build up an independent State which took away with one hand the good that the spending policy did with the other.

From Floor: What will the Government do with the funds collected? How will they invest them? Hypothetically, supposing that the Government has collected $20,000,000,000 or some other large sum, say in 1945, and then a heavy depression sets in. Wouldn't the withdrawal of money from investments and other places of repository have just as serious an effect on the business cycle as if the money were not saved by these premiums charged employers and workers?

Dr. Burns: Dr. Couper and I have had a little discussion about buck-passing on that particular question. Do you want me to answer it or Dr. Couper?

FromFloor: I was really asking you.

Dr. Burns: I will take a shot at it and Dr. Couper will tell you whether I am right.

Your first question - what will the fund be invested in? The money thus accumulated, if any is accumulated, will be invested in Government securities. It is deposited in the unemployment trust fund in the Treasury, and the Secretary of the Treasury is charged with the duty of investing such amount of that money as is not required for immediate payments, in securities issued by the United States Government or in securities for which the United States Government guarantees interest and principal. I should perhaps add that the Act gives the Secretary of the Treasury the power to buy either existing securities or to issue special securities for the purpose of providing investments for the fund, and it remains to be seen which alternative the Secretary of the Treasury will adopt.

Your second question related to the difficulty of investing such a large fund as $20,000,000,000. That is much bigger than anyone imagines the compensation fund will be. The fund which is causing people sleepless nights is, of course, the $47,000,000,000 fund that will be accumulated for the old-age benefits or annuities, but that is a problem which will really trouble our grandchildren more than us, because it won't amount to that sum until 1980. The unemployment compensation reserve is hardly likely to exceed two billion dollars. It is important to keep these two distinct.

The problem of realizing on the investment, however, will not arise in regard to the old-age annuity fund unless at some future date Congress should decide to discontinue the plan. For the function of the old-age annuity reserves is to yield interest. Thus by 1980, when the plan is in full operation, the annuities will be financed to the extent of 60%

from the current contributions of employers and workers and 40% from the interest from the reserve, and the Government will not have to make any contribution at all.

So far as the problem of realizing the unemployment Trust Fund goes, I take it that we can assume cooperation between the Federal Reserve Board in its open market policy and the Treasury, which has somehow or other to unload these particular bonds. In general fixed interest-bearing securities appreciate at the onset of a depression, but if there is a slump in the value in Government securities, some adjustment could readily be made. I do not think any difficulty will arise in the way of disturbing the general economic order when this money is spent, but rather the reverse, because one of the great advantages of giving guaranteed unemployment benefits is that it is a way of ensuring a continuous flow of spending.

One of the troubles at the beginning of a depression is that such a great many people stop doing what they did before; companies stop investing; private people stop spending; reserves pile up. The assurance that the Government will guarantee income to be paid to people who are unemployed, will bring about a circulation of money which otherwise would lie idle. It will involve a compulsory liquidation of these reserves.

CAN CAPITALISM SURVIVE?

By
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I. In the opinion of the speaker the answer to the above question is in the negative. But what counts in any such attempt at social diagnosis and prognosis is not the "Yes" or "No" by which we may sum up our facts and arguments but those facts and arguments themselves. They contain all that is scientific in the final result. Everything else is not science but prophecy. Strictly speaking, neither economics nor any other science ever foretells what will happen. To do this in a process which is the function of very many variables which are only partly amenable to exact measurement, would require super-empirical insight of the kind which is the very definition of prophecy. Economics or any other science can only state what would happen if a given process were allowed to go on in the same way as it did during the period from which we take the material for our analysis. This not only limits the scope of our subject but also bears upon it in a more direct way which may be pointed out at once: In the course of an argument presently to be entered upon, we shall draw conclusions about the future behavior of total output of commodities and services from the behavior of that quantity which we are able to observe in the past. There are several objections to this or any other extrapolation. At the outset we wish to mention but one of them: Owing to the failure of the conditions of the urn schema to be fulfilled, there is no sense in speaking of any "probable" future amount of total output, but our inability to justify any proposition on probability considerations does not mean that it therefore must necessarily lack any justification at all. If we fit a smooth function to any time series and extrapolate, the result need not have any forecasting value. As a matter of fact, in very many cases it is at once obvious that the expectation based on such a trend quickly leads to perfectly absurd results, but this means no more than that formal methods are not fool proof. If analysis teaches us that the trend expresses a real force or process which we have reason to believe will persist under certain conditions, there is no absurdity in extrapolating provided we keep in mind the above distinction between what will and what would happen.

Our question is indeterminate because of the many meanings one may attribute to the much abused word "capitalism" which indeed it would be best to banish from scientific terminology. Disagreement on our question is often due to this fact alone. One of the difficulties is the word must unavoidably designate different things according to whether we argue in terms of economic or sociological fact. We will define it as follows, stating expressly that this would be unsatisfactory for many purposes: Capitalism is that organization of society in which production is managed by private initiative with view to private profit. Needless to say, on the one hand, that this implies nothing about the social results of such an organization and, on the other hand, that alternatives to it are many and not satisfactorily

covered by the single word "socialism".

II. We must beware of the error implied in the widespread belief that it is economic performance which decides the ultimate fate of any form of social life. Not only are people perfectly unable to form an unbiased judgment about alternative possibilities (they would be unable to do so even if alternatives ever stood actually working before their eyes under exactly the same conditions) but mere economic performance would not in any case be decisive by itself. We observe, it is true, that advocates of either capitalism or socialism invariably hold that the system they espouse offers or would offer to the masses a higher standard of life than its competitor. This misconceives the real issue. More important than standards of living are the types of people and the civilization which a given system turns out; more important also for everyone of us is the question whether a given system agrees with our moral values and our cultural volition. But what people think and want is a secondary matter anyhow. The important thing is the logic of social situations, which among other things, makes people think and feel as they do.

If nevertheless we ask the question of performance, that is to say, the question what economic results may reasonably be expected from the mere working of the capitalist machine in the decades before us, it is only because for the economist that is the relevant question and not because we believe that the issue will be decided on this ground. In order to answer it we make the following assumptions: First, we assume that there is a precise meaning to the concept of total output of commodities and services. This is really the boldest assumption of all. It implies begging a fundamental problem of modern theory, but the reader is so accustomed to using that concept as if it were entirely unproblematic that he is not likely to have any qualms about it. Secondly, we assume that the function descriptive of the distribution of money incomes according to amount remains invariant. If this were an assumption about the actual course things may be expected to take it would almost certainly be contrary to fact. What we mean is that if the working of the capitalist machine were not interfered with that distribution would remain as it is. The warrant for that is in the fact that for the last hundred years that distribution has remained, as far as our statistics allow us to form an opinion, substantially invariant over time, although it fluctuated within the cycle. It is not necessary to assume the form suggested by "Pareto's Law", although the speaker thinks that critics have been somewhat unjust to that piece of analysis. But whatever the form of the function is, invariance is necessary for our argument, both because only if distribution in that sense is invariant can we conclude that variations in average income are by themselves sufficient to describe how all classes of society are going to be affected by a given increase in total output and because capitalist economy could not continue to work on at this same rate of progress if that distribution were so substantially changed as to interfere with the accumulation from the larger incomes, which is an essential piece of the capitalist mechanism and largely accounts for such efficiency as it has. Thirdly, we assume the absence of such events as world wars and revolutions.

Now, average income per head was about $700 a year in 1928. It is a conservative estimate that total physical output increased on the average at 3% compound interest per year practically as far back as our data carry us. Most readers

will be familiar with the more important of the indices which have been constructed to show this, and most of which would, indeed, support a more optimistic estimate, such as the indices of Warren and Pearson, Snyder, Day-Thomas, the Federal Reserve Board, the Department of Agriculture and others. Extrapolating and retaining the purchasing power of the monetary unit at the level of 1928, we get about four times (4.38) as much for 1978. This much be corrected for increase in population, which is an exceedingly controversial matter. Accepting Mr. Sloane's estimate of about 160,000,000 for that year, we come to the conclusion that an average income of about $2100 per head of population, purchasing power of 1978, would be reached about that time. Such performance may be considered satisfactory or unsatisfactory - that is a matter of taste and will largely depend on one's extra-scientific predilections. It certainly allows of the formulation, if we assume relative shares to be unchanged, that anything which according to our present ideas we should call poverty, would be done away with, even in the lowest strata of society, defectives alone excepted.

III. It goes without saying that injuries may be inflicted and even expected to be inflicted on the organism which will prevent it from producing the result glanced at. This is all the more serious a qualification because many things perfectly unavoidable under present ideas and standards, come within the meaning of those injuries. Very sharply progressive taxation alone would be sufficient. And so would be attempts to soften the hardships of adaptation to new situations as they arise in the course of industrial innovation. However, such injuries have never been absent and our 3 percent leaves plenty of latitude for the absorption of the effects. For this country that figure includes even the wastage of the world war. The rate would be different, of course, for European countries. It should be observed that when we speak of "injuries" we do not necessarily imply an adverse judgment. What is an injury within our strictly technical meaning may be an improvement from many other standpoints.

But the fundamental question is whether we are justified at all, injuries or no injuries, in looking upon persistence of that rate as at all likely. A majority of students of the phenomena of economic development (we had better avoid the word "progress") is inclined to doubt it, and you know that many authors, among whom we may mention S. Kuznets and A. F. Burns, have even tried to establish statistically the presence of systematic retardation. We need not repeat the familiar arguments which may be leveled against their methods but can confine ourselves to adding one more: material at all adequate to the task of forming an idea about the behavior of total output over time does not go back beyond 1870. If, in order to avoid the troubled time of the World War, we stop in 1913, that material covers two branches of what the speaker is in the habit of calling the Kondratieff wave. Quantitative study of economic cycles was, as you know, initiated by Clement Juglar. He assumed, as many students still assume, that there was just one such wavelike movement. But there are, on the one hand, theoretical reasons to expect that there should be many waves of different period rolling along together and superimposing themselves on each other, and there is the statistical fact that a "many cycle hypothesis" fits our time series much better than a "single cycle hypothesis". Mr. Kitchin and Professor Crum have established, as the speaker thinks beyond doubt, the existence of what is usually called the forty month

cycle, and Kondratieff discovered and described a very much longer wave which the speaker thinks has an average period of about fifty-seven years. For reasons which it is impossible to enter into here, the rate of increase of total output is greater in the downgrade than in the upgrade of the long swing - which is just the opposite of traditional opinion and should by the way lead us to revise the traditional judgment about the relative merits of "prosperity" and "depression". Now 1870-1897 lies on the downgrade of a Kondratieff cycle and 1897-1913 just covers the prosperity phase of another Kondratieff cycle. On the theory alluded to we should therefore expect that in the first span increase of total output was at a greater rate than in the second span. If this be so it would follow that our material would have to display what looks like retardation but should not be taken as an indication of a long time trend.

However, it is urged sometimes that the prewar rate of increase was due to the opening up of new countries both as sources of supply of raw materials and as markets for industrial products and must therefore be considered as historically unique. There seems to be a mistake in this, which may be linked to a particular interpretation of the old law of diminishing returns. What the theorem thus designated really says is merely that if you add successive increments of one factor of production while keeping constant both the quantities of the other factors and the method of production, you will get, from a certain point onwards, decreasing increments of product. If we designate by P physical product and by V_1, V_2 ......V_n factors of production, then the partial derivative $\frac{\partial P}{\partial V_i}$, is in the useful interval a decreasing function of V_i. But what the theorem was made to say was that however you change methods of production and however you combine, or add to, factors, nature will in the end display a decreasing response to your efforts. There is no warrant whatever for this. Of course, new countries counted for very much in the developments of the nineteenth century and even of later times, but the process of opening up new markets by means of developing new countries is only one member of a very large family which we call innovation. The introduction of new methods of agricultural technique for instance may shift the production just as, and more effectively than, taking new countries under the plow and achievement in that line is perfectly unpredictable. Once we have surveyed a given agricultural area, then given certain methods of production, it is easy to arrange, with reference to that method of production, all the plots of land existing in that area into a descending order of fertility or locational advantage, and to say that we shall take into cultivation first the "best" plot and then successively the worse ones, but we cannot say the same thing about the world of technical innovation which is not known to us and essentially refractory to survey. Hence there would be no sense in holding that we have been developing the most productive innovation so far and that only less productive ones are left for the future. This may be so, but the contrary is just as likely. In fact there is a reason to assume that the rate of technical progress will quicken rather than slacken. A hundred years ago, and still more so in the more remote past, innovation was a matter of individual will and vision, carried into effect

in the teeth of strong opposition. Now it is becoming increasingly mechanized so that organized research might be expected to turn out new methods which then will automatically be put into practice, much more systematically in future than has been possible in the past. Hence nothing is to be feared from either the law of diminishing returns or any of the arguments usually associated with it, as contemporaneous experience amply shows; lack of raw materials is not exactly what we suffer from.

IV. This is not to say of course that there are not other elements in the social situation of our time which may be very effective in producing retardation. They are of a socio-psychological kind. To begin with, every social or biological group applies itself to the task which is socially most important from the standpoint of the survival-interest of the group as a whole. This proposition is essential for what is to follow and should be carefully pondered and verified. Equally essential is the corollary that the social function which at any given time is the most "important" one in that sense, and success in filling it, supply the fundamental explanation for the emergence and the passing of what we call a Ruling Class. For instance, in a primitive agricultural tribe which has no means of defending itself by physical force and which is given to magical beliefs, say, of the animistic kind, magicians will be looked upon as the persons most important to the tribe and hence will rise into positions of social prominence and form, if the social environment is stable enough to allow of differentiation of a hereditary sort, the upper or ruling class of the community. Again, in conditions in which warfare and readiness for warfare are necessities of daily life and in which the technique of warfare is such as to require lifelong training (Such as the medieval technique of managing sword and lance on the iron clad horse), a class of warriors will grow up, establish itself as the socially ruling stratum and impress on the social body its own scheme of values and the form of life dictated by its interest and visions. Similarly, at a later stage and for reasons we cannot enter upon here, the function of economic leadership became in most countries we should be inclined to call "civilized", the socially most important one. To be sure, it was not economic leadership in general but an economic leadership moulded by preceding conditions and by the necessities of the historical environment - that kind of economic leadership which took the form of individual enterprise. And from these social necessities, and by filling that entrepreneurial function, the bourgeois class climbed into the saddle, impressing in turn its own values, interests and standards on the social psyche. We shall return in a moment to carry on this argument. Just now it is sufficient to point out that the very success of bourgeois capitalism tends to reduce its own importance for the future. As a result of its achievement that fear is rapidly dropping away from humanity which trembles in the prayer: "Give us this day our daily bread". As soon as this is the case, economic affairs will cease to hold that central position in the feeling and thinking of mankind that they used to hold and energies will not so exclusively be concentrated on economic tasks. This might well account for a considerable amount of retardation in the future.

Moreover, the success of capitalism, such as it is, is closely linked up with the method of selection for leading positions which was characteristic of a substantially

competitive system. It is worthwhile emphasizing that of all methods of selecting leaders which the speaker either historically knows or can think of, that is the only one that effectively tests the qualities which make for success once the leading position is conquered. The qualities that make a good candidate for political office are entirely different from the qualities that make a good administrator of the same office. But the qualities that make a man rise in competitive business are precisely the qualities which will make him a success when he has risen. It should also be observed that this important characteristic is rapidly vanishing from the world of giant concerns. But as the success of capitalism is fundamentally linked up with a peculiarly effective type of responsibility which consists in having to pay for one's mistakes: A politician who can make a successful speech or a public servant who can write a successful report, need not worry about an unsuccessful measure. But no ability of speaking or writing will be of any help to an entrepreneur if the balance sheet looks wrong. This again has ceased to be so in a rapidly expanding sphere of modern business. Finally, past success of the capitalist system rested largely, whatever some of the speaker's fellow economists may say, on that peculiar kind of financing enterprise which presupposes considerable inequality of income. It is not necessary to quote any statistics in order to convince you that the percentage of saving increases with the size of incomes. It would be necessary, however, to show that and why that method is so vital. But this we cannot do here. The disapproval of inequality and consequent attack on it is, however, an essential feature of modern political psychology and must be expected to asser itself more and more. Retardation from all those causes is, of course, more than likely and that is why we were so anxious to make above that qualification about "injuries" to the organism.

V. What has just been said by way of commenting upon and qualifying the expectation which might be formed about capitalist performance in the future from its performance in the past, immediately leads us back to the question at the head of this paper.

On the one hand, if capitalism is doomed it is certainly not doomed because of any rational proof that its economic performance is unsatisfactory in the sense that a country such as this could be reasonably expected to do better with respect to increase of total output by any of those alternatives which are at all within range of practical possibility. No doubt much more of fact or argument would be necessary to establish this proposition. We cannot do more than add a few remarks. To begin with, it must be borne in mind that much less weight than appears at first sight attaches to the argument which is resorted to by most of those people who otherwise and as a matter of trend would profess themselves quite satisfied with the rate of increase we actually observe, viz. the argument from fluctuations and the losses and sufferings incident to recurrent crises. If, following usage, we primarily stress the element of unemployment it must not be forgotten, first, that as a matter of arithmetic, the capitalist organism is at present, and can be expected to be still more so in the future, perfectly able to take care of the unemployed members of society. To put their services to some use and to prevent them from going to waste is of course one of the most obvious tasks of rational Planning. But whether or not this problem be successfully solved, the fact remains that the working of the

capitalist machine supplies all the means necessary to avoid anything that any people have a right to call suffering who speak quite coolly of such events as the "liquidation of the Kulaks." Secondly, it is matter of historical fact that those sequences of events which we identify as great crises or catastrophes can in no single instance be explained by the working of capitalist business alone. There are always, precisely in the worst cases, "external factors" present, wars, mistaken policies and so on. This field is, it is true, so much infested by monomaniacs especially of the monetary type that that should be obvious common sense is by no means easy to establish. But to any unprejudiced person it should be clear that the working of a system (never mind what system; think, for instance, of a system of balls connected by elastic strings) is one thing and interference with the system by external factors is another thing. This is no argument for laissez faire. On the contrary it is an argument for regulation that rests on an understanding of the material of the capitalist machine. But it is still very relevant to a judgment about the results attributable to that machine.

Furthermore the argument that private industry and trade work with an undue amount of wastage of resources, while possibly quite true, can not be made out by simply listing all cases in which a given result could have been achieved by smaller expenditure in terms of real resources. The usual method implies a comparison between the actual working of one system with the ideal of another, and entirely neglects the sources of waste which we might expect to discover were that other system put into practice. Apart from this many of the examples usually adduced are unconvincing because they often mean no more than that experimenting with new things frequently leads to failure. Such failures may be unavoidable in any system and what looks like unqualified failure may have its function all the same. Even what looks like simple social waste sometimes has a function. There is, for instance, certainly a great number of people engaged in running inefficient small retail shops, but the presence of those retail shops takes care of many people who would otherwise be temporarily destitute in the course of adaptation of rapid technological change. Now this may be an uneconomic way of taking care of them but the point is that we must not look upon the phenomenon as if it were a mere blemish and nothing else. Careful analysis on such lines reduces very much the strength of the prima facie case.

Again the argument from over-capacity, over-investment and over-production loses much of the weight it seems to carry the moment we realize that the more successfully progressive an economic system is, the greater will be, at any point of time, that amount of capacity which has been set up with a view to future demands and that amount of capacity which is already semi-obsolete. It is impossible to tell what would be left after deduction of those two items to which moreover it would be necessary to add all the capacity produced in order to cope with cyclical peak demand. Similar considerations apply to the case of over-production as distinguished from over-capacity apart from the fact that, taken in the ordinary sense, general over-production has no meaning at all.

These examples must suffice, but however we may think about them and other equally familar ones, so much is certainly true that the case against the performance of the capitalist system is much less strong and much less clear than public opinion seems at present to assume. Whatever the result of striking a

balance might be, had we the time to undertake the task, it is practically certain that it would not be spectacular and that it would not consist of negative items alone. In particular there is no excuse for holding either that if capitalism be left to itself things would, particularly for the masses, go from bad to worse or that the capitalist system displays any inherent tendencies towards economic breakdown. Both propositions have, as you know, been held by Karl Marx. But both have been given up by the leaders of Neo-Marxism. This is not astonishing with respect to the first, for it would indeed be difficult to hold that the capitalist machine turns out a standard of life for the masses that decreases over time. So after efforts had been made to interpret Marx, in the face of obvious evidence to the contrary, to have meant not absolute real wages, both totals and rates, but the relative share of the working class (in which sense he would also be wrong of course), that proposition was silently dropped. It is much more remarkable however that the Neo Marxists, from Hilferding onwards, also dropped the other, for owing to the recurrent hysterics about crises it would not have been tactically impossible for them to uphold it. But they were much too good economists to do that and hence handed the thing over to the literature of popular Marxism in which it flourishes still. It would follow, although this was, as far as the speaker knows, too much for them to admit explicitly, that it is no longer possible to base the case for socialism on the claim that in abolishing poverty it would do what the rival system was intrinsically incapable of achieving.

But, as pointed out before, this is not all nor even the decisive point. We might be socialists even if we recognize superiority of capitalism as an economic machine. There are higher things involved in one's social ideals than beefsteaks and movies, and even if it were not so, the future course of things would depend on the economic working and results of the capitalist system in a different and less direct way than that which lies between economic performance and rational choice of people. We may conveniently divide our argument into a psychological and a sociological branch, although there is of course no sharp dividing line between them. Every economic system moulds the souls of men by determining their working day and, through it, the attitudes, ideals and habits they develop. Capitalism rationalizes human thinking and human behavior. Examples to show that could be adduced in plenty from double entry bookkeeping to Neo-Malthusianism. This will produce concentration on the individual's interests and particularly interests amenable to rational formulation. All in human life that cannot stand the test of a very superficial kind of rationality is likely to be discussed away. For our proposition it is primarily important to note two implications of this: On the one hand rationalization of economic activity means scientific method, first on the technical, then on the economic or business side and this again means the mechanization of progress previously adverted to. The modern entrepreneur compares to his predecessor of a hundred years ago very much as a modern general compares to that picturesque sort of individual that used to fill the same function a hundred years ago. Managing a modern army is now a mechanized job in which a great number of specialized workers cooperate to turn out the result ready made and thereby to reduce the commander-in-chief almost

to insignificance. The application is obvious. On the other hand, we see now much more clearly than previous generations have realized, who were content with very simple arguments and justifications, that most of the emotional values of life cannot be formulated in rational terms. Among them are some which are of the utmost importance to the capitalist class and to the motivation of its members. Although we could equally well exemplify by the changed relation between entrepreneurs and the physical set up of any given factory, we will merely touch upon the most important source of individual motivation in capitalist society, the family. Not only has capitalist evolution created a rationalized scheme of private life within which the family house and all that it stands for is no longer a necessary, or even convenient, form of life, but it has done away, or is about to do away, with all the motivation for economic action that center around it. This process has indeed gone to very different lengths in different countries and within the same country in different regions and social groups. Peasants and farmers are, so far, practically untouched by it everywhere, but it is superfluous to stay in order to show how completely it has changed the moral world of the upper Bourgeoisie. This being so, their grip loosens both on their former ideals and on the position which are valuable mainly because of those ideals. That is why there seems to be no "fight" in them, when the system which is theirs is being challenged, and why they do not seem to believe in it themselves. The speaker knows that this statement is contrary to widespread opinion. Most people would think that the Bourgeoisie is defending itself and its interests all right. But apart from the fact that this opinion often rests on nothing more than the naive belief of the intellectual in all sorts of mysterious powers behind the political scene, what is actually done by that class is as nothing compared with what it could do if the will to survive as a class were not dying out within it.

Sociologically it is clear that the prestige of the industrial and commercial Bourgeoisie with other classes never has been as great as the corresponding prestige of the warlike upper stratum in the middle ages. There are many reasons why achievement of the type that was open to those warriors, should have been particularly apt to impress the masses that served them. No businessman, however successful in his office can ever hope to look to the rest of his countrymen as the knight did on his horse and in his armor. The latter's social function also carried the particular advantage that it lent itself as no other social function ever did to the direct and physical defence of the interests of its incumbents. To be able to draw one's sword in order to deal with an opposition necessarily deficient in the only technique available, is much more effective than to have to lobby with politicians or try to acquire control of newspapers and the like. It is indeed only with serious qualification that the Bourgeoisie could ever have been called the ruling class at all. In Europe it practically always submitted to the remaining feudal elements which in exchange protected it and drew a new lease of life from the fact. The great exception afforded by this country is accounted for by the absorbing fascination of developing an environment of great possibilities, and should not be relied on for prognosis as to the future. It is by no means astonishing that his origin, his past history and his

kind of work and mode of life should make the Bourgeois an ineffective leader or ruler. It would be astonishing if it were different. Hence social critique turned against him very much more promptly than it did against the feudal powers. The ideas of political democracy which he had made his own in the time of his servitude proved incompatible with the essentially monarchical ideas underlying the organization of business, all the more so because his democracy was typically of the eighteenth century type, and tinged with equalitarian elements which he soon learned to disapprove but which he never could successfully get rid of. The very increase in the standard of life, self-confidence and leisure in the masses which may be attributed to the working of the bourgeois economic system, produced an opposition which checkmated its upper stratum politically as soon as its feudal protector fell.

There is no need to elaborate this argument; it is clear enough in what sense it supplies a negative answer to our question. The interesting point about it is that, as far as ultimate results go, our answer is the same as that which socialists would give. Besides, there is the further affinity that we also link a prognosis unfavorable to the capitalist system to its economic results. But it is not its economic shortcomings that threatens it. On the contrary it is its economic achievements, and their effects on the human psyche and on the social and political structure of society, that is likely to kill it eventually.

It is another question how this prognosis may be expected to materialize. Some people like to indulge in speculation about the likelihood of revolutions. All we can say about that is this: What we term a revolution is akin to what in economic life we designate as a crisis or panic. Now an economic crisis is not the essential thing about economic evolution or, for that matter, the economic cycle. Fundamentally that wavelike movement that pervades economic life could go along and remain what it is, without those breakdowns for which we reserve the term crisis. The sum of phenomena we usually designate by it owes its existence to accidental circumstances. It may or may not occur and sometimes occurs on less provocation than there is in cases in which it is avoided. But in certain phases of the cycle those accidents are very likely to occur. Similarly what we call a revolution is nothing but a collapse of organization and morale. Whether it occurs or not is, from a long time view, of secondary importance and depends on random combinations of circumstances. This implies that our views about the likelihood of such events should differ for different countries, races and historical junctures. It is more important to note that, even apart from this, the outcome glanced at above though following logically from observable fact is by no means a certainty. Before humanity chokes in the dungeon of socialism it may well burn up in the flames of nationalist wars. The normal expectation for the Anglo-American world, however, is on the lines of a steady bureaucratization of economic life as well as of much besides.

SOME RECENT DEVELOPMENTS IN ECONOMIC THEORY

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I.

In recent years, some important results have been obtained in economic theory with the use of the same deductive methods as were employed by the classical economists, but on the basis of different assumptions. The new assumptions, being broader and more general than those of the classical economists, enable us to bring our theoretical constructions closer to the facts.

In order to compare the recent theories with the older ones, it is useful to divide the development of economic theory into three stages, beginning with classical economics - the economics of Smith, Ricardo, Mill, and their contemporaries as the first stage. The second stage, which began with Jevons and was developed further by economists of the Cambridge and Lausanne schools and others, is characterized by the generalized used of marginal concepts. This will be referred to here as the neo-classical stage. It differs from the classical stage more in terminology than in substance. Even in the highly elaborate system of equations formulated by Pareto we find no more than a refinement of the more abstract ideas of Adam Smith. The third, or modern stage has, I believe, made more fundamental changes. It is the nature and significance of these changes which I propose to discuss. It must, of course, be recognized that many of the ideas which are characteristic of the modern stage may be found scattered through the works of classical and neo-classical economists; but in classical and neo-classical economic theory these ideas are incidental; in modern theory they are central.

II.

Numerous efforts have been made to define in a few words the problem or subject matter of economic theory. Perhaps the central problem of classical and contemporary economics may best be described as that of finding out what collective results are produced by the choices of individuals interacting through contracts or bargains, under given institutional and natural conditions. It is clear that our economic system works the way it does mainly because of the choices made by individuals - and corporations - in buying and selling, but that the interaction of these choices produces results which have not been chosen by anyone. Depressions result from the interactions of choices, but no one chooses and proceeds to make a depression.

The manner in which the classical economists chose to approach this problem was determined by their political ideals and by the philosophical ideas about natural law which were current in their day. Nature, they believed, had made man selfish,

but it had also provided a set of institutions which would harness this selfishness to social ends. Under the "natural" institutions, selfishness would lead men to make such bargains with each other as would maximize the real income of society. But their language, "natural institutions" meant ideal institutions rather than the institutions actually existing.

These ideas were mainly responsible for the postulates or assumptions which the classical economists chose as a starting point in the development of their theories. One of the postulates which is fundamental to the main structure of classical and neo-classical theory is the existence of perfect competition, which means that the transactions of a single buyer or seller in any market are too small in relation to the size of the market to have any appreciable effect on the price. Another assumption of equal importance is that all persons in the economic system possess full and perfect knowledge of the market conditions relevant to their decisions. Since there must always be an interval of time between the decision to produce for sale and the actual production, full knowledge of the relevant market conditions necessarily involves the ability to make accurate forecasts. All the principal economic theorists have, of course, been fully aware that these assumptions do not correspond fully with the facts. Adam Smith, more realistic than some of our own contemporaries, recognized that combinations among employers to keep down wages are practically inevitable, making perfect competition in the labor market an impossibility. He also mentioned the short-time fluctuations of market prices, which are, in fact, largely due to imperfect knowledge. Nevertheless these facts find no place in the basic framework of classical and neo-classical theory.

From the postulates of perfect competition and perfect knowledge, it follows that the economic system tends toward a stable equilibrium, and that when this equilibrium is reached, the real income of society is as large as it can be, subject to those conditions which are not directly determined by the choices of buyers and sellers or the interactions of such choices. These external or environmental conditions include such things as natural resources, technical knowledge, and the framework of legal institutions. If these conditions change, the system of interacting choices will adapt itself to the new set of conditions by moving toward a new equilibrium with a new structure of prices and production. Once the adaptation has been made, no further change will take place without a further change in the environmental conditions, except for a gradual, steady development resulting from the growth of population and accumulation of capital.1/

Thus, the theory of economic equilibrium might better be termed a theory of economic adaptation. The main emphasis in classical and neo-classical theory, however, has been on the end-result of the process of adaptation rather than on the process itself. Much attention has been given to the long-run results of adaptation to changes in environment without entirely adequate consideration of the intermediate stages. Under the influence of this attitude of mind, supply curves and demand curves have been thought of as <u>timeless</u> relationships between quantity supplied and price or quantity demanded and price - a type of relationship which

1/ As a general statement about classical and neo-classical economics this is an oversimplification. Ricardo and his followers treated both the growth of population and the accumulation of capital as a part of the process of economic adaptation. In neo-classical economics, population is treated as one of the environmental conditions, while the accumulation of capital is regarded as a process of growth with no definite end in sight.

has no counterpart in the real world. While it is true that Marshall analyzed the relation between the long run and the short run in considerable detail - and perhaps this was Marshall's most important contribution to economic theory - many of his followers have used "timeless" supply curves, cost curves and demand curves in their theoretical analysis.

III.

It is a commomplace that the doctrine of laissez-faire started out as a revolutionary program, was gradually transformed into a program of moderate reform, and has finally become the creed of those who are opposed to nearly all the present tendencies of social change. The theories of Adam Smith provided, in his own day, an approximately correct analysis of the way in which the economic system worked. They also showed that a removal of the innumerable restrictions which hampered production and trade would result in a beneficial adaptation. By about 1870 Adam Smith's program reached its nearest point to full realization.

Since then, the world has steadily moved away from the doctrines of Adam Smith. Moreover, important changes in our economic organization have taken place, giving rise to phenomena which cannot be analyzed by a theory of stable equilibrium and perfect competition. The structure of the world's industry has become increasingly monopolistic. Our price structure has tended to become more rigid, at least by comparison with the late 19th century. For reasons which I shall mention later, the tendencies to instability appear to be increasing.

In the late 19th and early 20th centuries, a gradually spreading loss of faith in laissez-faire expressed itself in numerous criticisms of classical and neo-classical economics. Veblen was perhaps the most important of the critics. He pointed out that the framework of individual motives and of legal institutions postulated by the classical economists, so far from being natural to man in any scientific sense, were peculiar to a very recent phase in the development of human society. Veblen's emphasis on historical and anthropological perspective tended to raise serious doubts as to whether human society would continue indefinitely to be organized on an individualistic basis. But so far as concerns the development of theoretical, deductive economics, they produced no immediate result. Veblen's followers made no attempt to widen the scope of neo-classical theory by using new and more general postulates, but threw overboard the whole apparatus of deductive analysis.

IV.

During the past ten years a new emphasis on monopoly has arisen among economic theorists, and has already found its expression in a considerable theoretical literature. Previously, a theory of monopoly had been developed by Cournot as early as the eighteen-thirties, and this theory was later incorporated by Marshall in his Principles. It remained, however, a kind of economic curiosity, not organically connected with the general framework of economic theory. The theory of monopoly was generally considered applicable only to certain special industries in which a single producer has no

competitors who supply an essentially similar commodity or service.

The basis for the modern approach was apparently first suggested by Edgeworth, who pointed out that monopoly and competition are not mutually exclusive. Even the most ironclad monopolist must compete for the consumer's dollar with the suppliers of other commodities. If we define a monopolist as one who is the sole supplier of a given commodity in a given market, then the meaning of the word monopolist depends on what we choose to select as our commodity. Is Henry Ford a monopolist because no one else produces Ford cars, or is he a producer in a competitive industry because there are many other producers of automobiles? There are all shades of variation from extreme monopoly to the case of the farmer who can sell as much as he can produce at the prevailing market price. The greater the reduction of price which a seller must make to expand his sales, the more monopolistic is his position. Perfect competition is at the zero end of the monopoly scale.

Edgeworth suggested that a general theory of price be developed on the basis of this conception of monopoly. In such a theory, perfect competition plays the role of a limiting case, as, in Physics, some of the propositions of Newton are limiting cases of the more general formulations of Einstein. Unfortunately, Edgeworth's suggestion was ignored for many years. The modern work on monopoly was stimulated by an article by Piero Sraffa, published in the Economic Journal in 1926. In this article it was pointed out that the actual situation in retail trade and in manufacturing industry differs very significantly from perfect competition. An individual manufacturer or retailer may make considerable cuts in price without thereby making possible an infinite expansion of his sales opportunities. Advertising by the individual seller would never pay under perfect competition, but apparently it does in manufacturing and retailing.

Among the literature which has appeared since the Sraffa article, two books, namely, The Theory of Monopolistic Competition by E. K. Chamberlin and The Economics of Imperfect Competition by Joan Robinson are particularly significant in that they include an attempt to analyze the significance of monopoly for the economic system as a whole. This attempt, however, is only a first beginning, and the main conclusions are not new. It is pointed out that the existence of a considerable degree of monopoly in important industries leads to a relative underdevelopment of the more monopolistic industries and tends to make the distribution of income more unequal. It is also shown that with a more monopolistic organization of industry a lower rate of real wages is necessary to secure full employment, but that such monopolistic organization is in itself not sufficient to account for unemployment. Perhaps the most interesting and original result is the one which touches on the much discussed problem of "excess capacity". It is shown that under certain conditions monopolistic competition leads to the existence of a larger number of productive plants than could produce the existing output in the most efficient manner. This means that each unit is producing less than the output which would enable it to operate in the most economical manner.

Thus, even in the absence of fluctuations of purchasing power, which are not considered in the book at all, it would appear that monopolistic or imperfect competition does give rise to some waste of resources. An example of this is to be found where a gasoline station is placed at each of the four corners of a road intersection where any one of them alone would be sufficient.

The theory of monopoly has been extended by Joan Robinson and others to analyze the case of a monopolistic buyer. This analysis is of particular importamce in connection with the labor market, since perfect competition among employers is, to say the least, an extreme rarity. R. F. Harrod has shown in a recent article in the Quarterly Journal of Economics that, under certain conditions, an increase of wages through collective action by employees in a single industry may tend to increase employment, although the opposite has generally been accepted by economic theorists as universally true.

The contributions to economic theory of the new approach are due to the abandonment of the assumption of perfect competition. Its deficiencies are probably due, for the most part, to the fact that the assumption of perfect knowledge has not been abandoned, and that "timeless" relationships have been assumed. The type of analysis used by Joan Robinson and others tells us how a monopolist could maximize his profit _if_ he were in full possession of the relevant knowledge and _if_ the response of consumers to a change in price were immediate.

A topic which is now receiving much attention is the rigidity of prices which exists in fact wherever the position of sellers or buyers, or of both, is significantly monopolistic. It seems fairly clear that no theory of monopolistic competition can be adequately equipped to explain rigidities unless the assumptions of perfect knowledge and of timeless relationships are abandoned.

First, with regard to perfect knowledge, it is clear that no monopolist possesses a complete knowledge of the relevant conditions, since it is impossible to predict exactly how consumers will respond to a change in price. If conditions change in such a way as would call for a reduction of price, the monopolist will not know exactly what the new price should be. It seems likely that such uncertainty, combined with the bureaucratic inertia of many large corporations, is responsible for some considerable amount of rigidity.

A further cause of uncertainty arises from the fact that the price which it is most profitable for any one monopolist to charge depends, among other things, on the prices which are charged by his competitors. A monopolist who contemplates a change in price must know how his competitors will react to such a change before he is in full possession of all the relevant knowledge. This aspect of the problem has been considered by Chamberlin but not by Mrs. Robinson. An interpretation of Chamberlin's analysis appears to suggest that when a group of monopolists are in competition with each other, each will hesitate to take the initiative in reducing price, for fear that the rest will immediately follow his example. Hence at a time when demand is declining, there may be no reduction until it has become fairly clear that a general reduction of price will benefit the whole group.

If we now proceed to drop the assumption of timeless relationship and to distinguish between

long run and short run reactions, it becomes possible to bring theoretical analysis still closer to the facts of price determination under monopolistic conditions. The method followed by monopolists in determining their price policies appears, at least on the surface, to be incompatible with the methods of marginal analysis developed by economic theorists. Monopolists apparently aim, as a general rule, to set a price which will cover their average cost and, if possible, some margin of profit. When an industrial plant is producing less than that output which it can produce with maximum efficiency - a condition which is true of most plants most of the time - any further reduction of output will increase average cost. This fact is often used by monopolists as an argument for not reducing them, or even for raising them, when demand is reduced. Now, marginal analysis has shown that this argument is valid only if, with a reduction of demand, there is also a considerable reduction in the elasticity of demand. Mrs. Robinson has attempted to show, on the basis of timeless relationships, how a reduction of demand might be accompanied by a reduction of the elasticity of demand, but she has been able to do so only by making some additional and rather questionable assumptions.

As a general rule, the elasticity of demand is greater for the long run than for the short run. A monopolist who reduces his price will at first add little to his sales and may actually reduce his profit, but after a lapse of time he may add to his sales more than enough to compensate for any temporary loss. Hence, if it can be shown that the monopolist is in a better position to consider the longer run when demand is high or increasing than when it is low or decreasing, this will supply the missing link in his argument. It is, in fact, fairly clear that when a monopolist is already making a profit and the financial position of his business is strong, he can afford to make a temporary sacrifice for a greater gain in the future, but when he is making a loss, financial difficulties may compel him to take a more short-sighted view.

Moreover, when profits are being made, and particularly when demand is expanding, the charging of a high price is likely to be a short-sighted policy for a further reason. The monopolist who charges a high price is inviting his competitors to expand their productive capacity and attract new customers by charging lower prices. He is also inviting new competitors to enter the industry. When price is below average cost, these dangers are much less likely to exist. Hence, it seems probable that competition in most industries is far more monopolistic in times of depression than in more prosperous times.

V.

Recent contributions in the field of monetary theory are perhaps even more important than those in the field of monopolistic competition. Their significance lies partly in the fact that modern monetary theory is no longer a separate system from the rest of economic theory.

In the classical and neo-classical stages of its development, economic theory was artificially separated into two parts; the theory of value and distribution, and the theory of money. Under the heading of value and distribution, <u>relative</u> prices, production and the distribution of social income were studied on the basis of postulates which implied a tenden-

cy to stable equilibrium. One of these postulates was the assumption of monetary stability. The quantity of money was treated as one of the external or environmental conditions which are not affected by the system of interacting choices of buyers and sellers. So also was the velocity of circulation, which was regarded as determined by more or less stable habits of buyers and sellers.

Monetary theory was concerned primarily with the final adaptation of the economic system to a change in either of the two monetary conditions. It was easy to show, on the basis of the postulates used, that the adaptation to any given increase in the quantity of money, such as might result from the discovery of new gold deposits, or in the velocity of circulation would, in the final equilibrium, result in a proportionally equal increase of all prices. Relative prices, production and income distribution would remain unchanged. It was, of course, recognized by as early a writer as Hume that, because of price rigidities, any change in the monetary conditions must affect the volume of production and employment, and the distribution of incomes. But these results were regarded as temporary and short run phenomena, and any analysis of them was incidental to the one main proposition of monetary theory - the quantity theory - which dealt with the final equilibrium.

This theory was originally developed to explain the effect on European price levels of the influx of precious metals from the New World during the 16th, 17th and 18th centuries. It was not adequately equipped to deal with all the economic processes of a world with a highly developed and intricate banking structure. Moreover, the structure of economic theory, with its equilibristic postulates, and its treatment of monetary conditions as environmental, imposed severe limitations on the theoretical analysis of business cycle problems. It is impossible, while remaining strictly within the framework of this structure, to account for any disturbances of equilibrium which may be generated within the system of interacting choices. On the other hand, it is hard to find any changes in the environmental conditions which can explain the apparently rhythmical character of business cycles. Faced with this dilemma, classical and neoclassical economists tried various expedients. John Stuart Mill put forward a theory of crises in which he abandoned the classical postulates of perfect foresight and rationality. Jevons invoked the aid of astronomy in the search for a rhythm of environmental disturbances which would put business cycles on the same basis as seasonal fluctuations.

Modern theory possesses the means of analyzing monetary disturbances which originate within the system of economic choices. The credit for this is due most of all to Knut Wicksell, a Swedish economist who published his first important work in the late nineties of the last century. Unfortunately, Wicksell's work passed almost unnoticed outside of Sweden, until the publication of J. M. Keyne's <u>Treatise on Money</u> in 1930. Wicksell's main contribution consisted of an analysis

of the way in which a monetary disturbance can result from the operation of the system of interacting choices. Although each of the principal elements in Wicksell's theory had been anticipated by various forerunners, no systematic and thorough analysis of the matter had been made before.

Before Wicksell, it had been usual in economic theory to assume that in the capital market, as in other markets, the quantity supplied must equal the quantity demanded, which is one of the conditions necessary for equilibrium. It was assumed that investment, that is to say, the payment for capital goods, is possible only out of savings from income. This implies that an increase of expenditure on capital goods can come about only with a decrease of expenditure on consumption, and vice versa.

Actually, however, this is not necessarily true. In a society where promises to pay can be used as means of payment, funds for investment can be obtained simply by creating new promises to pay. This is what happens when bank credit is expanded. Thus, if owing to a new invention or some other external change, new and favorable opportunities for investment emerge, an increase of investment may be financed by an expansion of the means of payment, or in other words, by an increase in the quantity of money, and without a corresponding reduction in expenditure on current consumption. The same result may also occur without expansion of the means of payment, if the emergence of new investment opportunities induces persons to convert their cash balances into real assets. In this case we have an increase in the velocity of circulation. In either case, with the emergence of new investment opportunities, investment can be prevented from outrunning savings only if the rate of interest is increased sufficiently to check the increase of investment.

The fundamental difference between Wicksell's theory and the pre-Wicksellian or equilibrium theory is as follows: According to the older theory a decision to invest can not be made without a corresponding decision to save, or, in other words, to reduce expenditure on current consumption. The two decisions were essentially one and the same. According to Wicksell's theory, which is in accordance with the facts, either one may be made without the other. According to the older theory, if there is a change in investment opportunities or in the disposition to save, the rate of interest will automatically change in such a way as to preserve equilibrium. In Wicksell's theory, the actual rate of interest, which Wicksell calls the market rate, may differ from the rate that is necessary for the preservation of equilibrium, which Wicksell calls the natural rate. If the market rate is below the natural rate, there is a tendency to increase the total amount of expenditure on capital goods and on current consumption; when the market rate is above the natural rate, total expenditure tends to be reduced.

It will be observed that Wicksell's analysis can only explain the way in which a monetary disturbance is generated by reference to some change in the environmental conditions, such as a new invention. But it does explain how a monetary disturbance can arise out of the response of the system of choices to a change in those external conditions which are themselves not monetary - and this response is not a movement towards a new equilibrium.

The next step in Wicksell's analysis takes us even further away from the classical framework. An increase in total expenditure creates more favorable opportunities for investment, thus leading to a further increase in total expenditure. Thus a movement away from the equilibrium, once it has started, acts cumulatively. This is known as the Wicksellian cumulative process. The economic system, instead of tending to move toward equilibrium, tends, at least in one very important respect, to move away from it. Equilibrium is no longer considered a necessity as inevitable as it is desirable; it has become an objective which is extremely difficult to attain.

In connection with the further development and the application to practical problems of the Wicksellian theory, both the rigidity of prices and the absence of perfect knowledge are of extreme importance. Those who have heard Professor Viner's lecture in this series will understand without need for further explanation that if there were no rigidities, monetary disturbances could not cause nearly as much unemployment and waste of economic resources as they do. In addition to this, rigidity necessarily plays an important part in the development of the cumulative process. The lag of wages behind wholesale prices when total expenditure is increasing is an important accelerating factor.

The importance of imperfect knowledge in connection with the Wicksellian process becomes apparent as soon as we recognize that all investment involves planning for the future. When business men are induced by an increase of total expenditure, with its accompanying price changes, to increase investment, this is because they at least expect the improvement in investment opportunities to last for some time. It is not the actual present expenditures and prices which directly determine investment, but the expectations of future expenditures and prices. Any development which effectively influences expectations must correspondingly influence the monetary situation. Expectations often contribute much to the instability of our system because, when a Wicksellian process has once got started, expectations of its continuation tend to accelerate the process itself. In Wicksell's own formulation of his theory, expectations played a passive and silent role. Wicksell himself was too steeped in the preconceptions of classical theory to abandon the assumption of perfect knowledge consciously. A reformulation of Wicksell's theory based on recognition of the importance of expectations has recently been made by Gunnar Myrdal, a member of the Wicksellian school in Sweden.1/ Myrdal's theory contains the assumption that the degree of uncertainty in regard to the future has a significant influence on investment. The greater the degree of uncertainty, the smaller will be the disposition to invest.

The analysis of Wicksell's process has brought economic theory much nearer to an understanding of business cycles. But it does not tell us definitely what causes are responsible for the

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1/ J. M. Keynes, in his latest book, <u>The General Theory of Employment, Interest, and Money</u>, which was published after this lecture was delivered, also places great emphasis on expectations.

semi-regular reversal which brings a Wicksellian process in one direction (either expansion or contraction) to an end and initiates a process in the reverse direction. There are, no doubt, various causes for these reversals and in all probability they differ in relative importance from one reversal to another. One of these causes, which has been noted from time to time by economic theorists, but has perhaps not been sufficiently emphasized, is what is known as the replacement cycle. J. M. Clark, in his recent book, Strategic Factors in Business Cycles, has attempted to show the importance of this factor. During any period of economic expansion, there is a considerable increase in the construction and purchase of durable goods, including both capital goods and durable consumers' goods. After a few years of such expansion there will be little need for the replacement of worn out equipment. Partly for this reason, the market for durable goods becomes saturated, and general economic expansion is followed by contraction. Similarly after several years of stagnation, the need for replacement may being about a general re-expansion of economic activity.

VI.

With regard to the practical conclusions which may be drawn from recent contributions to economic theory, it is inevitable that there should be a wide range of differences in opinion. I propose here to make a few suggestions, without claim to originality.

At the present stage of development of our economic system there would appear to be a trend towards greater instability. As the productive forces of society increase, the relative importance, in production and consumption, of durable goods tends also to increase, and hence the disturbing role of the replacement cycle is magnified. It is possibly for this reason that the last depression has been more severe and more prolonged in the United States than in most other countries, despite the fact that other countries were more severely affected by the international financial collapse. Furthermore, monopoly, and the rigidities which result from monopoly, appear to be increasing.1/ Not only is there a fairly general tendency toward greater monopoly in most industries, but there is also a tendency of those industries in which monopoly is important - the metallurgical and chemical industries, and the industries which produce durable goods - to gain in relative importance.

Under these conditions the need for a stabilizing monetary policy seems likely to become increasingly urgent. In the various proposals for monetary and credit

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1/ Professor Viner, in his lecture in this series, mentioned certain reasons for believing that greater rigidities existed in the 18th century than at the present time. But this is no reason for abandoning the generally accepted view that rigidities have increased since the latter part of the 19th century. Moreover, rigidities were presumably of less serious consequence in the 18th century, when banking, the capital market, and the production of durable goods were relatively less important.

reform which are being discussed at the present time, there is great variety. Their name is legion. But all those which can make any claim to scientific respectability have, underlying them, one fundamental idea, namely, the adjustment of interest rates in such a way as to preserfe equilibrium. Even those few economists who still hope that equilibrium can be maintained by the application of some simple, mechanical rule, would presumably admit that their rule can only be effective if it results in the appropriate adjustments of interest rates.

There do, however, appear to be some serious limitations to the effectiveness of interest rates as a means of preserving equilibrium.

The relationship between interest rate and investment, like all other such relationships, is not timeless, but involves a lag. The decision to make an investment necessarily takes a certain amount of time, which in some cases may even involve litigation over land or patent rights. When the decision has been made, further time is consumed in planning the details, and after the actual work has begun, there is often a considerable lapse of time before the expenditure on labor and materials reaches its maximum. If it is remembered, further, that the effect of interest rates on investment is cumulative, it is clear that at least several months must pass before any reduction of interest rates can have a marked effect on investment. The lag is likely to be particularly great when anticipations are pessimistic and most business men are unwilling to make commitments for the future until they see other business men doing the same.

Consequently, if a period of active replacement and construction is not to be followed by depression, it may be necessary to reduce interest rates a few months <u>before</u> the decline is due to set in. But such a reduction of interest rates at a time when expectations are mostly over-optimistic is apt to encourage investment on an unsound, speculative basis; and this may result, at a latdr date, in a situation which makes depression even more difficult to avoid.

It is likely that this difficulty is more serious now than it was a few decades ago, and that it will be even more serious in the future. It must be remembered that a stimulus to investment may, in general, result from any of three things: growth of population, new inventions, and reduction of interest rates. The growth of population tends to call forth a quantitative, horizontal expansion of the capital equipment of society, without much qualitative change - the building of additional houses for the increment of population, extension of the railroad system to open up new territory for the production of additional foodstuffs and raw materials. By contrast, new inventions and reduction of interest rates call forth the construction of new <u>kinds</u> of capital goods to <u>replace</u> (not merely to supplement) the existing equipment. This gives rise to a qualitative or vertical growth of the economy. It also gives rise to the problem of technological unemployment.

In all countries of mature industrial development, the rate of population growth is showing a marked tendency to decline. In several European countries population has already reached a plateau, and an absolute decline in numbers is likely to develop in the next few decades. In this country the maximum will be reached in two or three decades, if not before. This change must necessarily have a profound effect on the nature of capital goods

construction. It is at least possible that such construction will proceed with even more irregularity than in the past. During the period of rapid population growth, whenever investment came to a temporary standstill, a reduction of interest rates was sufficient to re-start the process of horizontal expansion in a relatively short time. It was fairly easy to see along what lines the expansion was to continue. But at the present time, when further economic growth must necessarily involve a much greater qualitative change, uncertainty regarding the future must necessarily be a more serious obstacle to the revival of investment after a depression, and the time consumed in making plans and preparations, which tends to involve an increasing amount of scientific and technical research, must necessarily be longer.

It seems not unlikely that depressions will, in the future, tend to become more severe and prolonged, and that it will become necessary, to an increasing extent, for governments to revive purchasing power by their own expenditures. It is questionable whether any considerable amount of recovery, such as we have had since the last depression, would have developed in this country without unbalanced budgets. But the use of government expenditure as a means of reviving economic activity is also, in the long run, beset with serious difficulties. For unless government is to make its expenditures of borrowed funds on a remunerative basis, which would, on any large scale, mean entering into direct competition with private enterprise, a stage must be reached, sooner or later, in which the government's debt is so large that no further borrowing is possible without serious risk of financial disorganization.

INTRODUCTION TO THE COURSE

By
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All of us who are here this afternoon, I assume, have some connection with the Government. Whether we are government employees or not makes no difference--we all have some connection with the Government. And as I see it economic life is just that close to government. There is no separation between the two.

It is not uncommon to divide the discussion of problems of government and problems of economics. Our academicians in the colleges and universities are responsible to a certain degree for that. They must have courses in economics, and they must have courses in Government. The result has been that they have separated a common body of thought, a common body of action, into two more or less similar fields, neither of which can really be intelligently studied without the other.

The courses in government are usually concerned with administrative machinery. You study the way the courts and the executive departments are organized. Elsewhere you may study political philosophy, but the courses in "government" have come to be courses in administration. On the other hand, most of the economic courses study "supply and demand" and "the market," with little recognition of the fact that supplies and demands in an actual world and their effect on the market is directly tied in with the kind of government which we have. Supply itself means actual supplies in the hands of individuals or groups of individuals who have the right, a legal right established by the Government, to withhold from sale. The basis on which the study rests is government.

In recent years, however, we have been swinging back a bit. Some of the early textbooks that were written in what we today call "Economics" were in earlier days called the "Principles of Political Economy." In those books this close relationship between government and economics about which I am talking today is frankly recognized. It is the renewed interest in that type of analysis which interests me in a course of this kind, which deals concretely with economic problems, that is to say, with problems of the way in which people behave when they are making their living, as well as the problems of government which is the way groups of people organize in order to achieve certain common ends. The combined study is political economy. And so, in future weeks when you have lectures in taxation, banking, and so on, they will be discussions of political economy.

Let us approach our problem for today in a slightly different way. It is customary to talk about the breakdown of laissez faire and its replacement by governmental control. But laissez faire was a form of governmental control. What we have is not the disappearance of that government control, of laissez faire, of freedom to do as you please, but the shift from one form of governmental control to another form of governmental control for different purposes. The problem is not "freedom" versus "control" at all, it is one form of control versus another.

Why does it seem that the decisions of Government today are of more importance in economic life than they have been in the past? Not because the relationship between government and economics is any greater today than it was, but because the economic machine itself, and the governmental machine which goes with it, is a more complicated

machine. A decision in one part of the body politic affects another part much more than it did when we had a simpler mechanism. It is this intricate relationship, how it came into existence, and what its nature is, that is the real concern of this series of lectures.

I should like to give you some illustrations, drawn in broad strokes, with which you may well disagree. There is lots of room for difference of opinion. Keep one thing in mind, however, that I am limiting myself this afternoon to relationships between economic life and government, and I am consequently leaving out a lot of other significant and important things.

Look first at the economic organization of life in the Middle Ages. That is really very close to us. It is only a few hundred years ago, a short time in the life of man. Some of the basic things in our own economic life root in that period. They have their origins there, and are quite similar to what we have today. Let us think first of the governmental organization and then of the economic organization. In doing this I am violating my own first cardinal principle that there must be no separation. But we will break it for purposes of analysis. On the governmental side we have two outstanding organizations--the Church, and the Holy Roman Empire. There is the Church with its hierarchy, from priest to pope, establishing a coordinated form of relationships within that great body, having courts of law, holding property, administering the spiritual welfare of broad lands --a strong, throughly organized agency. On the other hand, we have the Holy Roman Empire, closely linked in some ways to the Church, in other ways quite separate--the body which is usually called the Government of Europe during that period. What was it? A shadowy, hazy form, with an emperor, some electors, and numerous kings and dukes, and their retainers and subjects loosely linked in a haphazard organization. It was a name, almost a fiction. It met occasionally, and elected an emperor. The emperor had little power. The real power lay in other places.

Here were two governmental administrative forms. But neither one of them makes much sense until we turn to the other side of the picture and see them in relation to the economic life of the time. In that economic life agriculture was the most important activity, agriculture organized largely on the basis of the manor. The manor itself was a distinctive institution which might be classed as a governmental institution as well as an economic one. This governmental form, this manor, established the relations between the lord of the manor, the serfs, and the land. The lords of the manors might also be dukes, or hold other high-sounding titles. The relationship between the lord and the serf, and the feudal relationship between the other members of society who were above serfs in status, was on the basis of rights and duties. But those rights and duties involved always certain economic responsibilities. The serf had certain duties to his lord, and in turn the master had certain duties to him. This was true whether the manor was dominated by a layman or by a churchman. Many Church officials both high and low were also heads of manors.

The economic picture then of that agricultural life is a series of almost entirely self-contained units, each unit a complete community organization. Any work that was done in these communities was related to all the other work through the mechanism of the manor with the lord at the head centering the governmental form. He was the court of last resort, if you please, in decisions affecting all of the economic life of that small body. Within the Church there was a more formal relationship, but even then the challenge of one section to another was important. Each was practically independent,

even while recognizing the spiritual headship of the Pope. Likewise, the dukes and lords were independent, so independent that they would challenge each other, and it was on the basis of their strength that in later times we begin to see the gradual formation of the European state. But here they were, strong men, each with his followers, to be used as soldiers at one time, as workers at another time. The relationship was just as close as that between government and economics.

Turn your attention to the manufacturing and commercial fields. In the manufacturing field, of course, (here we use the word strictly and quite accurately--manufacturing: hand-making), the organization of the guild was the predominant form. And these guild organizations, while scattered in a rough way over the face of Europe, were largely local in power. It was only in the later days, when the commercial guilds developed into strong trading organizations, that we see them in their heyday. But the interrelationships are again important. Such goods as were available were traded at the fairs which were held at regular intervals. Many fairs, the most outstanding ones, were connected with religious festivals, and people came long distances to the most famous ones for trading goods. Small fairs, serving a local neighborhood, met oftener, once or twice a month, or perhaps a couple of times a week. All of these forms of organization are important, but I think you will notice the difficulty I have had in speaking of governmental forms and economic forms as separate things. The close relation of the guilds, the fairs, and the towns, is apparent. Likewise the manor and the agricultural life are virtually identical. All are intimately connected with church and empire.

Another illustration, the city states of North Italy. Here is something quite different from the feudal organization. It really looks like the state, whereas the amorphous Holy Roman Empire resembles hardly at all a nation or a state. These small cities had real powers of government. What was the basis for it? Well, The cities were located, practically all of them, on the shores of the Mediterranean. They were all commercial centers. They were in conflict with each other, and you see springing up another governmental form which is important with all modern nations, the navy. So the battles of the Middle Ages that took place on land, on the basis of feudal governmental forms, with rough armies that went out to fight each other with the crudest kind of instruments, are matched by the development of naval battles between the ships of one maritime city and those of another maritime city. These were the dominant powers related to two different types of economic life.

As years roll on and we come to the sixteenth, seventeenth and eighteenth centuries, we find this commercial strength in Italy and Spain about the same time, then later in France and England. In those four areas are the beginnings of real national life, of governmental forms, such that we today might begin to recognize them as national states. That commercial life, like the life in the Italian city states, came to a focus in navies, in battles that were fought all the way around the world. Recalling your American history, you will remember the Spanish voyages of exploration, all of which were closely related to the commercial life of the time, seeking for the westward routes, the trade routes.

With the decline of Italy and Spain, France and England came to the fore, and the development of the techniques of fighting and the use of ships are closely related

to the expansion of the commercial life of both those great countries. Again recall your American history and the struggle between those two powers for the domination of this continent. Recall, as an incident to that long struggle, the establishment of the colonies which later became the United States. This struggle on the seven seas was matched on land by the further growth both of economic life and governmental power.

As we come to the middle of the eighteenth century, we begin to hear of the rise of the bourgeoisie, of the strength of the city people. Now, the term of course is French, and in France agriculture dominated the scene. It is when the cities begin to assert themselves, when the commercial people grow strong, when the slowly developing industrial life produces strong cities, that the conflict makes itself felt. When the nation, which was an agricultural nation with forms of government related to agriculture primarily, becomes commercial, the necessity for strong centralized government makes itself apparent. When exchange becomes dominant rather than production for local use, then central government becomes important.

When the struggle for power between these two groups becomeskeen, hard, and sharp, then governmental forms, the development of parties, and their struggle for the control of that government become somewhat separate. Now here you see the growth, the shift in form as the economic life has changed. Let's have just one more illustratoon in that sector.

I have said practically nothing of the development of Central Europe, particularly Germany, Austria, and Poland. That particular part of the world retained the medieval form until the middle of the nineteenth century, and then through an important invention, namely the railroad, Middle Europe developed the commercial character that maritime Europe had had previous to that time.

It was the railroad, essentially, that made possible a unified Germany, and the development of all of middle Europe. Without such a change in the technique of transportation the growth of these areas would have been next to impossible. Here again the development of the nation as a strong, central unit depended upon the growth of economic life, and conversely, it was impossible to develop a strong and closely related economic life without a governmental form which would keep the peace between the various parts and parties to the economic life.

What was the development here in our own country? I referred to the development of the colonies as an incident in the struggle, the commercial struggle, of western Europe. The time came when the American merchant himself was more than anxious to break away from European rule to protect his trade and see to it that his interests were taken care of by a government of which he was part.

At the same time that this struggle between American and British and French merchants, which we have called the Revolutionary War, was going on, there was another struggle taking place, the struggle between the American commercial interests and the pioneer agriculturists. The form of government that we adopted reflected those basic and fundamental divisions of interest.

Think for a moment of the Articles of Confederation, a loose governmental form that represented the loose set of economic interests of the colonies scattered along the seaboard. Who were these interests? A group of commercial people who had invested in government securities, who owned lands that needed protecting, who were involved in all kinds of commercial interests. Each group was

trying to protect by local action interests which were not local. What did we need? A central government that could take care of those interests, money, bonds, lands, a central army, naval protection, no tariff barriers. The men who met together in the Constitutional Convention to write the Constitution that has stood through all these years, worked on that basis. Basically that is why it has lasted; because it was written to meet fundamental needs. The form was set by a group of men who were intimately acquainted with the life of their time.

But notice, these men were concerned with central governmnnt, and another group had not been taken i into account. The men who were not represented at the Convention were concerned more directly with local economic problems. The result was that before we could have the adoption of the Constitution, we had to have the addition of the ten amendments, in which lay the protection of the local interests. The interrelation between the governmental form laid down there and the economic life of our time was so close that any other way of viewing it seems superficial.

Again I remind you that there were other forces of importance, but I am not going to talk about those this afternoon. Given an American form of government, with its tri-partite set-up, let us think about that in relation to our economic life too. A nation was formed; it was a growing nation. It expanded, took in new states, and provided new people with government, with the Constitution itself flexible enough so that as the character of economic life changed the governmental forms were fitted to it even within the Constitution.

And yet, strangely enough, much of our political life goes on outside the Constitution. Think for just a moment about the way in which we elect a President. The most important steps are not mentioned in the Constitution. After all, there are party conventions; and party organizations which go out to all parts of the nation. And yet there is nothing about those parties in the Constitution. When we finally get to the Constitutional forms that must be observed, we go through with them. We have developed government outside the Constitution when that instrument did not provide for the specific forms. There is nothing unconstitutional about it; it is just one of those things that is extra-constitutional.

Now with the development of these new governmental forms we have also had changes within the three major branches of the government itself. The first exhibit that I would give you would be a copy of the Constitution, a little pamphlet. The second would be this tome, the U. S. Government Manual, which most of you use from time to time, this great list of government bureaus. A simple form of government as outlined in the Constitution, but in order to deal with the great mass and intricacy of our economic life, you have the need for all these things, and the end is not yet. And then in addition to this, there is the intricacy of state government, and municipal government. I just want you to get the breadth of that picture, the impossibility of dealing with our economic life without having these agencies.

To be very concrete in connection with the present-day relationship between government and economics, I would like to discuss briefly one of the most importand Federal agencies, the Interstate Commerce Commission. This Commission was established in the last quarter of the nineteenth century, and its

powers were gradually expanded until we now have what is popularly called regulation of the railroads. What have been the sources of this expansion? There was the demand on the part of the small business man for the regulation of rates--that is important. Also the farmers demanded rate regulation--that was even more important. Then there was the demand on the part of the railroads themselves for the regulation of cut-throat competition. Any single railroad today might say "We don't want regulation for ourselves", but if you were to ask that railroad whether the railroad industry should be left without governmental regulatoon, the answer would probably be "No." Rail transportation simply could not function without this regulatory supervision. There might well be changes in details, but basically the conflicting interests are of such magnitude that only the commonly recognized governmental form can deal with them.

The Commission is a relatively new agency, but none of the newer agencies of government are more important than the older ones which are less often referred to when we speak of government regulation. It is these older agencies which establish the basis on which most of our modern economic life rests. Take just one important item--the corporate form in American life. I hope Dr. Means will talk about that in considerable detail next time. I wish to say just one or two things. The corporation is a creation of the state. It is given specific immunities by the state. How daring, how speculative, would the average corporation be today were it not for the privilege given to the stockholders of corporations that their liabilities are limited. The very freedom which this privilege gives these corporations is made possible only because of the control of the state. That is the thing which I am really trying to say. When you get freedom, you get the necessity for government--control is inherent in the establishment of freedom.

In thinking of the relationship of the various parts of the government to our economic life let us not be fooled by the separation between the judiciary, legislative, and administrative parts of the Government. Each one of these parts does the same thing in different ways. The legislature performs judicial functions; the judiciary performs executive and legislative functions; and the executive arm of the government makes decisions every day which are the equivalent of court decisions, and at times takes action which closely resembles legislation. This is a part of the everyday routine for most of us if we only stop to think of it.

All of this seeming infringement by one part of the Government on another part is really necessary. Some problems can be handled best by administrative procedure, others by judiciary, others by legislative. The essential question is one of procedure rather than one of basic differences in the type of action taken. If we were to make our judgments on the basis of which procedure fits the type of action which is necessary, there would be less confusion in discussing the difficulties between the courts, the executive, and the legislative branches of the Government.

In closing there is just one thing I want to emphasize. The statement of the question in terms of freedom versus regulation does not pose the problem at all. The real question is "What kind of government relations will be established with our economic life, and what type of relationships do we really need if we are going to be able to carry on a struggle for a healthy national life?"

DISCUSSION

Question-

I do have a few questions, Dr. Woods. I understand that this lecture was to have been an introduction for this course on the relationship of government to economic life, and before asking any questions, I would like to say that Mr. Blaisdell's lecture raised the most important question for that course which could possibly have been raised. Since the basic question is one that is controversial, and since it is my task today, as a questioner, to disagree with the thesis of the speaker, I am going to raise the opposite point of view.

Mr. Blaisdell, you have said that governmental and economic life are the same, that they are part of one discipline and essentially the same thing, and it seems to me that if that is true, that would imply that in their actual physical counterpart in the structures of government and economic life they should be made one. In other words, that the state should be the controlling agency for all our economic life, it seems to apply that the state should own all of the property and operate all our factories and distribute the products of those factories to all the people. My first question is, do you agree with that implication, and, if not, what limitations would you put upon it?

Answer-

I take it, the question is - should or should not the state own the means of production?

Question-

Yes, I think that would be it.

Answer-

It is a matter of opinion. I will give you my opinion. There are times, and there are situations in which the state should, without question, own the means of production. I believe that there are other cases where that would not be wise, where the productive apparatus might be made to function with a variety of legal relationships between the individuals who make the productive mechanism function and the mechanism itself.

Question-

Well, another question that you raised in my mind was in connection with the extensiveness, as opposed to the intensive point in our economic life, to which the state should reach, and in tracing the development of government and economic life from the Middle Ages up through modern Europe and to the United States, you pointed out that in the earlier period at least the functioning governmental unit was co-extensive with the economic unit, as in the Italian city states and feudal manors. As I consider the economic life of today, it seems to me that its limits stop nowhere. In other words, the world, as has been pointed out frequently, is today an economic unit, and I wonder, without

pushing for a direct and immediate world state, whether you do not think that perhaps the logical future development of government should be in direction of a state of which we are a part and, if not, do you think, as many people do, that instead of extending the state to meet or to cover the world economic organization of which we are a part, it might be wise instead, because of political situations, to limit the economic life, as many nations at present are trying to do, to the limits of the present states?

Answer-

I hate to be dogmatic but I would like to put it this way, that when the national, or when the worldwide economic interests do predominate in the form of a powerful economic organization, we will have a world state. You can not separate the two things, and the unification will just come, although not by magic or anything of that sort. The two things are so much a part of each other that, as the situation is today, you have circles in which various national interests come to a head-on clash. First the commercial engines of war meet and fight in the economic markets, and later they use the battleships. However the inter-relationship even today of our economic life on a world scale rests on a fragile base, and it is not surprising that international governmental forms have not become very strong. You might draw the analogy at the present day between the League of Nations and the Holy Roman Empire. They are very similar institutions.

Question-

I have one more question, not quite as broad as the other two, and then I will give the rest of you a chance. The extra-constitutional government agencies which you have described in your survey, as you pointed out, meet at points with the constitutional agencies which we have and with the provisions for the expansion of our government which actually are in the Constitution. I wonder if you would tell us what you think about the effectiveness of a program of rewriting the Constitution or amending our Constitution in order to bring the extra-constitutional agencies within the scope of the actual written document. Would you think that it would make these organizations more effective if such a general policy were to be followed? Of course, I am not talking in terms of changing the Constitution in one swoop, but just the general policy of trying to question the idea of bringing under the Constitution certain agencies which seem to be caused by changes in our economic life.

Answer-

Personally, I think it would be tragic to try to incorporate these extra-constitutional things in the written document, and my reasons for it might be a little bit peculiar but I will give them anyhow. Whether it is in the executive arm of the government, or whether it is in the judicial arm, or the legislative arm, there are certain rituals which have to be gone through with, certain prescribed ways in which to operate.

In the executive branch we call it red tape, in the legislative branches we call it parliamentary law, or something like that, and in the legal branches we call it legal procedure.

In every one of the government forms we have certain things to go through with to be sure that we get to the intended objective. In our Constitution it is something like that, - there are certain things we have to go through with in order to be sure that we get there. Some of them take on great importance, others take on less importance, and these ritualistic things are a part of all of our lives and I, for one, do not want to get rid of them. To think of the Constitution in terms of a mechanical document would seem to be tragic because it would wreck all of our good rituals.

Question-

Dr. Blaisdell, in answer to the first question of Mr. Swanger, it was pointed out that there are certain justifications for the government controlling the means of production in some cases and not in others. I wonder where we could draw the line.

Answer-

I can not answer the question because, as a general proposition, I think there are no general rules for government operation. I remember when I was a student at the university, one of my most revered professors gave me a list of rules by which I could tell which agencies should be owned and operated by the government. Of course, the post office was one, and the schools another, etc. I have had the feeling that it is a matter of taking particular industries in connection with particular techniques of operation and studying out, on a technical basis, how we can secure the best operation of those industries. I know that is not a satisfactory answer but it is the best that I have been able to do.

Question-

Mr. Blaisdell, there are a good many extra-constitutional agencies, like trade associations, employers' associations, trade unions, cooperative agencies, etc., which exercise control over economic behaviour. From your point of view then, they exercise governmental control. Now, would you advise expanding the power of these organizations, whether voluntary or cooperative, or limiting their power through bringing them under greater regulation of the state?

Answer-

I recognize your point, and I think it is well taken, in drawing attention to this type of agency which does perform a type of regulatory function and yet is not a part of the state. The reason I did not speak of that kind of agency more in detail was that I was talking particularly of government itself. You are asking about the border line between these two. Again, I feel that it is not a question of what we ought to do, or where we should draw the line, so much as it is a question as to where is the line which these agencies themselves and those that are opposing these agencies will draw - will they draw the line so as to make them universal in their scope or by putting limitations on their scope. That becomes a pragmatic

question in connection with particular associations. To be specific, one of the larger manufacturers' associations in the lumber industry performs an important grading function the results of which are recognized as legally binding, yet, we will say this is a non-governmental function. On the other hand, in the grain trade, for instance, we have government inspectors who do essentially the same thing. This border line is the place where the struggle is going on continuously as to whether we shall incorporate in the government a particular mechanism or leave it outside the government. I would be just as undogmatic in that as I am in the question of public ownership. There again, it is a question of the study of the situation and working out the best way in which to solve the problem at hand.

Question-

I wonder if it would be pertinent to make some mention of the research agencies which have been developed - that the United States Government has a number of research agencies, but it has been also said that they are largely unconsolidated. I would like to ask if you would comment on that fact - there are the Central Statistical Board, the National Emergency Council or the President's Council, the Library of Congress, and so on, - if these are coordinated and if not, whether they should be so, and how.

Answer-

I would like to say this about research in government - that through its research the government has made tremendous contributions to our economic life. The success of any research is dependent to a considerable degree on the freedom with which it is given to move this way or that way. That is what it is. It is a search, and the minute you try to coordinate it too closely for fear this man is going to overlap that man you defeat that purpose - it may be they are both searching in the same material and the one man finds what they are looking for and the other doesn't. In many fields we have had thousands searching and only one has found the answer, but if we had not had the thousands searching, perhaps the one would not have found it.

I am fearful, therefore, of too much attempt to correlate and coordinate. At the same time, there are limits to which any expansion of that kind of thing can go and it is for the purpose of drawing these limitations that a reasonable amount of coordination is required.

MONETARY CONTROL

By

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I haven't prepared a lecture and I hope that you will bear with me for a little, while I outline in a general way some of the thoughts that occur to me on the subject. Incidentally, I did not select the subject or name. If I had, it would not have its present name, "monetary control", because I do not like either of the two words, particularly the last one.

Control implies pretty complete ability to handle the situation, complete to the point to which few human powers can aspire. We can sometimes influence conditions. We can exercise such influence as we have in one direction or another, but there are few economic factors that human instruments and human ability have learned to control, and I think that it is particularly wise to avoid that phrase in most connections, because while it may be used with a lot of qualifications in the minds of the user, with his tongue in his cheek, it creates a misleading impression of a belief in the ability to control economic facts completely.

I am not going to talk about the various kinds of controls that exist but I am firmly convinced that monetary control does not exist and that, within the framework of our economic and political organization, monetary control can never exist. It will not exist until such time, if such time ever arrives, when the government will control substantially all economic activity.

I said that I did not like the last word of the title, well I do not like the first word "Monetary" either, because it generally has a connotation that is not as broad as the conception of control of money and credit, because "monetary" very frequently means control through the monetary units, gold and silver, which restricts the field even more than it needs to be restricted, so that if I were naming what I wanted to talk about, I would say something like "The extent to which a government agency can influence credit and currency developments towards a definite objective." It probably could be reduced to four words, but it gives you an idea of what I have in mind to talk about more precisely and accurately than the words "Monetary Control."

There has not been much success achieved in the field of monetary management or credit control in this country and in my opinion in any country, although no doubt there are different views on that subject. If you take the developments in this country since the establishment of the Federal Reserve System, prior to which there was no effort at any central control at all, if you take it since that time and view the period of inflation that occurred between 1917 and 1920, contemplate the period of deflation, violent deflation, in 1920-21, take the period from 1922-29 with its gradually insidious inflation of a specific kind that developed, and then consider the collapse of 1929 culminating in 1933 with the closing of all the banks, and view efforts to revive business by monetary means since that time, I think that there can be no two opinions about the fact that up to date the science of monetary control or the art of monetary control, whichever it may be, has not yet reached the stage of creditable performance. And if we are ever going to have it, it is perfectly patent from this record that that art has not yet reached the point of serving the purpose of maintaining business stability, or price stability, or any other

objective that may be assigned to it. It is perfectly clear that the technique has not as yet been good enough to prevent undesirable excesses in the credit situation in either direction, either in the way of preventing enormous expansion or ruinous collapse.

I think that it behooves us to be very humble about it because it is a record of failure. I do not want to convey the impression of calling it a record of failure of the Federal Reserve System or of the Federal Reserve Board or even of the banking system, because it is a failure that is much broader than that. I think it is the failure of our economic institutions. I think nearly everything has failed, otherwise we would not have had the kind of depression we have had with the kind of suffering and the continuous army of unemployed. All I mean to say is that the field of which I speak has not yet demonstrated that it can be used in a way to prevent or even to moderate materially the broad, wide, sometimes abrupt fluctuations in the course of business and that therefore the subject that I mentioned as the one that I would speak about is very much more appropriate because much more modest than the broad and somewhat arrogant title of monetary control.

There are those who believe that whatever influence is exerted in the credit field should primarily concern itself with the quantity of credit and that many of the difficulties that have arisen came from the fact that there has been too much attention paid to quality and not enough to the quantity. That is one view. There is another school that believes that the control of quantity is neither feasible nor particularly desirable because more stress should be laid on the demand side rather than on the supply side. This school claims that the failure of the banking system is largely due to the fact that banks were permitted to get into an unsound condition and that better supervision, better legislation, closer control over the banks would have prevented that part of the depression which may be traced to credit policy. These views represent two opposing schools, both of which are emphatic in their views and grant little or nothing to the other point of view.

It is my opinion that under ideal conditions, which of course never exist, the two are essentially identical because if one had complete control of quality it would limit quantity, and if one had complete control of quantity, it would determine quality. To explain that in a little more detail, I mean that if we had such complete power and authority over the banks that no loan was ever granted and no investment ever made that was not fundamentally sound and in the interests of the general economy; if the proportion of a bank's funds that went into loans and the proportion that went into investment, and the character of the loans and investments were all definitely subject to control and were responsive to it, it is rather obvious that the aggregate amount would be one that would also be in the best interests, because every loan and every investment would serve a useful purpose and would have been granted with due regard to developments in the particular line in which the loan and investment went, and to general developments. It would, therefore, be adapted to existing conditions, and you would have a situation where qualitative control would give you a complete control of quantity.

On the other hand, if you had a complete control of quantity so that the amount of money would always be exactly the right amount for the needs of business, and by the needs of business I do not mean the desires of business, because the desires may exceed or fall short of its needs, but the legitimate deneeds, the needs that were in the best interests; in other words, if money knew better whether it is needed than the people who want to get it, you would have a control of quantity that would carry with it a control of quality, because if you could not get any more than was wanted, any more than was good for the country, the chances arė that the distribution of it would work out fairly reasonably and that in the aggregate you would have a situation in which the quality of your loans and your investmentswould be fairly good, granted a reasonable quality of management. So that in ideal conditions, both of those schools would find themselves in the same position. They would find that a very complete, thorough control of one involved as a corollary a pretty complete control of the other.

The truth of the matter is that, whichever is the more important, there are many obstructions in the way of complete control either of quantity or of quality of money.

To mention briefly the limitations on qualitative control: One is the widely dispersed authority for chartering banks. Banks are not all chartered by the Federal Government. They are chartered by all the State authorities, and there is no uniformity in legislation or supervision, A bank or branch may be chartered legally, a great many may be chartered legally for which there is no economic need, and they may, by their very numbers, become a danger to stability.

Another limiting factor on the control of quality, which is closely related to the one before, is the dispersion of supervisory authority. All laws determining what banks may and may not do, the laws that prescribe the reserves that banks must hold, the laws about examinations and the quality of the examinations, differ from State to State. The Federal Government which has supervision over only the national banks and in a minor degree over the State banks that are in the Federal Reserve System, does not have the authority to make the banks that are outside comply either with the law or the practice that may be established by the national bank. That, of course, is a great limitation on qualitative control.

I might say in passing that even if all the banks were subject to one authority, there would still be great limitations to what can be accomplished by supervision because the best supervision in the world cannot take the place of wise management. In the first place, no examiner can be in a position to know all of the circumstances of every transaction in every bank no matter how conscientious or wise and experienced he may be, but in addition to that, there are a great many things that may happen in between examinations that could not be foreseen or prevented by the examiners. So, there are real limitations on what the very best supervision can do, and that also constitutes a limitation on qualitative control.

The fact that we have 15,000 banks makes supervision very much more difficult, makes the control of quality very much more difficult because it makes it very hard to supply enough banking talent for all those banks and to have anything like a well-established banking tradition and banking principles. It is very much more difficult to accomplish that with the large number of banks.

that we have than it has been in such countries as Canada and the other countries of the world where there are, generally speaking, only a few large banks with high-grade talent at the top and with mutual understanding, and with a well-developed tradition. Whether or not our policy of preventing the consolidation of banks and branch banking has had justification in our American circumstances, in our American traditions, is a bigger subject that I can go into today, but the fact that the multiplicity of our banks makes qualitative control much more difficult I think would be granted by anyone.

Another limitation on the control of quality is deeply rooted in human nature itself and in economic conditions. Frequently what looks quite good as an individual thing may be pretty bad when there is a lot of it. In other words, a loan on sugar, for example, at a fairly high price may be a good loan for the individual bank when the bank knows the borrower and feels that his credit is good, but if a great many banks are making a great many loans on sugar, it may develop into a bad speculative situation in the sugar market sending the price of sugar up to 30 or 35 cents and then having it tumbling down to six cents in the course of a few weeks, with the result that a great many of the loans turn out to be bad loans. The point I want to make is that in the judgment of the bank the transactions that come to it may frequently be perfectly good as far as the particular transaction is concerned, and yet may not be so good in an aggregate situation. It is not so easy to see what is happening in the whole field as it is when there are fewer banks.

And still another limitation on qualitative control is the fact that there are a great many things that are outside of the influence of the banks and still may affect the situation and may result in disastrous conditions. For instance, a group of loans by a number of banks may be perfectly good, even in the aggregate, and yet may become entirely bad by the occurrence of a drouth or by the occurrence of an over-supply somewhere else, by a collapse of the foreign market, by a collapse in prices, or by any number of economic mal-adjustments. In other words, banks, being only a part of our elaborate economic mechanism, may find themselves completely overwhelmed by economic maladjustments for which their own personal powers do not prepare them and against which they could not have safeguarded themselves by the exercise of the greatest wisdom and the greatest talent in management. In other words, so long as our money economy is subject to the tremendous contortions that it has been subject to, a complete qualitative control of bank credit is not feasible.

Perhaps that is enough on the subject of the limitations of qualitative control. I want to say a few words also on the limitations of quantitative control.

The Federal Reserve System, which is national and is the body responsible for such influence on the volume of credit as may be publicly exercised, has a number of powers into which I do not think I could go today but with which you are probably familiar. But there are other agencies that have powers that may at any time greatly interfere with such quantitative control as the Federal Reserve System may exercise. Principally the Treasury. Under our present legislation and monetary situation, the Treasury is a monetary authority in its own right. It has the power of increasing the supply of reserve money through the purchase of silver, through the issuance of greenbacks, which it has authority to do up to

$3,000,000,000, if it chose to do so, and through the spending of the stabilization fund of $2,000,000,000. The instruments of quantity control possessed by the Federal Reserve System through open-market operations, rediscount rates, changes in reserve requirements, and in margins for security loans, are not the only powers in existence. Another authority has adequate powers to frustrate, if it chose, any quantitative policy that the Federal Reserve might choose to adopt.

The monetary powers are distributed among two agencies that have no official need to cooperate, although they have every economic need, and as a matter of fact always have cooperated very well. But outside of that, even if the powers were concentrated in one authority, there would still be great limitations on quantitative control. This has been very well illustrated in the last three years. The Government policy has been in the direction of easy money, creating deposits; the Government has created a great many deposits and it has made it extremely easy for private individuals to borrow at very profitable rates, and what has happened? Government borrowings have created deposits, but the volume of business has not increased anything like in proportion to the increase in the volume of money and there has been a great diminution in the velocity of those deposits.

I am not saying that the effort was not worthwhile and that it has not done a great deal of good, but I am pointing out the limitations of that power. You can create deposits, but you cannot make them circulate. On the other hand, as far as private deposits are concerned, you cannot even create them because no matter how easily money may be obtained, no matter how low money rates, you cannot make people borrow if they do not see the prospect of profitable use of the borrowed funds, and you cannot make banks lend if they are under the influence of fear, as they were in the earlier part of the depression. With the liquidity complex on the part of the banks and with the great and well justified hesitancy of business in the light of what happened to business in 1930 and 1931, it has not been possible, notwithstanding a continuous and strenuous easy money policy on a scale greater than has ever been pursued anywhere in the world at any time to reestablish private borrowing. The present volume of loans is still near the bottom. While deposits have been created by Government borrowing, and the volume has been restored to practically what it was at the peak, the use of these funds by the owners for spending or investment and the borrowing of them by business has been so much less that the volume of business is still much below what it ought to be to keep this country prosperous.

In addition to those limitations which might be overcome by certain policies or certain methods or proposals that have been made, and I am not going into them today, there is the limitation in which the Treasury figures again in a different capacity. I was speaking of the Treasury's monetary powers a while ago, but even the Treasury's direct fiscal powers, the powers which by all logic belong to the Treasury and must be exercised by the Treasury have a great bearing on the control of the quantity of money. Whether the Government is going to spend a lot of money or not, and if it is going to spend it, whether it is going to spend it by raising it by taxation or by borrowing, and if it is going to raise it by borrowing, whether it is going to borrow from banks or borrow from investors; how it is going to repay its debt, where it is going

to hold its deposits, how it is going to handle its numerous trust funds; all those factors have monetary significance and a bearing on the quantity and distribution of money. They cannot be ignored by any monetary authority. It means, therefore, that a complete coordination of fiscal policy with monetary policy on a scale that has never yet been vizualized or carried on in any country will have to be developed before an adequate control or influence over the quantity of money can be established. In the final analysis, a really complete control of the quantity of money does not seem to me to be possible without a very complete control of the flow of the national income and its distribution, and that means a very definite degree of control over private enterprise and private undertakings in private life, on a scale that we have not as yet been prepared to contemplate with equanimity.

I have traced all these limitations not in a spirit of skepticism nor in a spirit of apology for the limitations of what our particular institutions can accomplish. I have sketched them for the purpose of indicating that it is best to recognize that we are working in a very complex scheme; that we have nothing like complete control and that there are economic and human factors that limit complete effectiveness of the control.

The question may be raised whether in the light of what I say the well-known principle that the central bank should be entirely independent of the Treasury or of the Government, will stand up. In anything like the sense that the advocates of that independence use it, it does not stand up. The Federal Reserve authorities cannot effectively operate without complete cooperation with the Treasury, not only under the present and exceptional circumstances, but even under the best circumstances. Even if all monetary powers were in the Federal Reserve authorities, there would still be the power of taxation, of determination of the amount of borrowing and redemption. Those factors are important parts of monetary management, and yet have a number of angles that have nothing to do with monetary control. It is therefore perfectly logical that the monetary authority and the fiscal authority have to work hand in hand, closely together, so that the sense in which the slogan "the central bank must be independent of the government" has been generally used does not, it seems to me, fit the circumstances.

It was primarily a reaction against the experiences of Europe during the War, when the Central Banks became adjuncts of the treasuries and means of issuing fiat money. In the final analysis, even that is not the root of the matter. The root of the matter is that there was a war at all, because when there is a war, you cannot finance it by taxation because you would not have the support of the people - at least so far you never could - and if you are not going to finance it by taxation, and if you cannot stop to economize when the one and only national object is to win the war, you have to spend the money, and therefore you have to inflate. Whether you are going to inflate through a Central Bank or whether you are going to inflate through the printing press is not a matter of vital importance. Of the two, inflation through the Central Bank has the advantage of a little more restraint, and particularly more restraint after the crisis is over, because if you have an inflation that does not cost anything, it is much more likely to continue to be doing mischief when the particular necessity has passed. The cry for

independent Central Banks, independent from the Government, was an outcry caused by the painful experience through which most of the European countries went during inflation, during and after the War. It was, as so many of the slogans of that sort are a partial idea resulting from a particularly painful experience.

In my opinion, the independence of a Central Bank is important. It is important, however, if you understand it in the sense that the monetary authority, whether it be a Federal Reserve System or a central bank or whatever name it goes by, should be so familiar with its subject, should have so high an understanding and wisdom, courage and public spirit that the fiscal authority would not for one moment consider undertaking any policy that had any monetary bearing without full consultation with the monetary authority. Both have the same objective of the public service and the public welfare. They must work out in so far as possible such a monetary procedure as will best serve the best fiscal policy, and suggest fiscal procedure as will serve the best monetary policy, - in other words, a complete exchange of information, each being expert in a somewhat different field.

To that extent a central bank should be independent - in the sense that its advice should be taken in matters that have a monetary bearing. I think it is in that sense and in that sense alone that the Bank of England is independent. The Bank of England is extremely close to the Treasury. They have constant, daily consultations, and the Treasury does not undertake a refunding operation of any kind, or any important fiscal action, without consultation with the Bank of England, and the Bank of England would not at any time do anything that would embarrass the British Treasury, but they are independent of each other in the sense that they meet as equals, they have respect for each other and they work out a common policy on both fronts that is to the best interests as they both see them. I think it is probably fair to say that because of the greater permanence of the management of the Bank of England and the very high degree of talent which it usually commands, it may be that the Bank of England has more influence on the Treasury than the Treasury has on the Bank of England. I don't know whether that is absolutely so or not, but it certainly comes nearer being so than it is in any other country of the world. It is a matter of the specific weight of the personalities in control of the management.

The point I want to make in that connection here is that in order to even approximate an effective influence on monetary development, we have to work out a procedure by which the fiscal and monetary authorities will work hand in hand. I think, myself, that even the fiscal and monetary authorities together could not completely control the business cycle, if you want to use that phrase, because I think that that cycle depends in the final analysis on the volume and distribution of income over which neither of these authorities has or can have absolute control. There are still other phases which would have to be adjusted so long as the work is in the general framework of our present economic set-up.

Recognition by monetary authorities of the limitations of the field in which they can be effective is not to my mind a discouraging recognition. It seems to me it is a stimulating recognition. It is very much better to know what the limitations are and to try to adjust yourselves to them and to try to remove them in so far as possible by cooperative methods and by whatever means may come to hand, than to have

a belief in a limited number of instruments of control which are expected to be patented for the purpose of accomplishing the impossible.

Just one more word before I close. In connection with this discussion of the controls and particularly the limitations of the controls, - the question arises of the objective of the controls. What should be in general terms the objective towards which all these powers such as they are and such as they are not, be exercised? Frequently, the objective mentioned is price stability. It seems to me that price stability as such is at best only an extraneous matter. It may be desirable to prevent violent fluctuations of the general price level, but the price level consists of so many different extremes that the limitation on changes in the total is not always reflected in a healthy situation of the constituent parts. Prices are in any case only one of a large number of things that need to be considered. I cannot go into that big subject today, but I wanted to say that I think that one of the false objectives that has been advocated by many monetary theorists is the objective of price stability. It has been abandoned by many of them. I think that it is probably true that even business stability may not be a logical objective, because stability might mean lack of growth and development. It might mean an attempt at a status quo. I think that, while most people who advocate it would recommend limitations of it, it seems to me that it stresses a factor which in our unstable human nature is not a particularly appealing or effective factor. I think that so far as we can formulate an objective, it should be a full utilization at all times of all the resources of the nation, both human and material; in other words, to use all the material resources and all the human resources of the nation to full capacity.

I think that carries with it an implication of proper distribution, because a full utilization at all times, I think, in the final analysis, means a reasonable and effective distribution that would continue toward utilization of all resources. I think the objective of monetary policy should be a full utilization of the nation's capacity, and towards that objective the monetary authorities will have to work with such instruments of influence and cooperation as they may possess.

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DISCUSSION

Question - Sweden is supposed to have exercised a considerable degree of monetary control. They are supposed to have kept their price level in that case constant. I would like to know whether you think that is a fact, and, if so, whether or not it has been successful.

Answer - I realized, when I expressed a doubt about whether it has been successful anywhere, that Sweden would be mentioned. I am not absolutely prepared to say whether it has been successful or not. I think that Sweden has had a good deal of recovery and a pretty stable price level. I think it is very likely that there are a great many other elements in that picture besides monetary control as such. I know that, at the time I looked into it, the maintenance of a fairly stable price level seemed to mean primarily that the Swedes had gotten less for what they sold and paid more for what they bought, and that it averaged out as stable, with no particular benefit for the people. I do not think that is any longer true. I think they have since developed beyond that point. It is a field that needs pretty careful further

study, and it is a much simpler economy than ours. I think it is not unlikely that they have been able to accomplish more in that field and rather more conscientiously and deliberately than most other countries.

Question - I was interested in your statement that a reasonable objective of monetary effort should be to accomplish a further utilization of resources. That is expressing it in general terms. I was thinking of the present time when we are seeking a fuller utilization of resources, and was wondering what particular things a central monetary authority might do to accomplish that further utilization of resources.

Answer - That is putting me on the spot. It is much more than I can answer in a minute, but I should say in a general way that, at this particular time, with recovery proceeding at the rate it is proceeding, the best that a monetary authority can do is to try to encourage business activity in borrowing and lending for the purposes of business activity, and at the same time keep as much of a firm hold as possible on speculation, especially in particular fields like the stock market, real estate market, and other places where it may be developing. I think that we are not starting from scratch. We have a situation that is full of wreckage, and in charting our course we have to follow a rather dangerous course to avoid the rocks. It seems nevertheless clear to me that at this stage there should be more attention paid to the general methods to be prosecuted.

Question - You stated that the objective of control should be the full utilization of the resources, and rejected the idea of price stabilization as being an objective. There are certain divisions of the Department of Agriculture which think a great deal of trouble has been brought about through the disparity between the group of agricultural prices and the group of industrial prices. Can monetary control, using it in the broader sense that you have spoken of, do anything to correct the disparity in levels between those groups of prices?

Answer - That is just exactly why I am not in favor of price stabilization, because you can have a great maladjustment of different elements. I think, speaking in the terms of the regular monetary theorists, they always say that the adjustments between different groups of prices are outside the field of monetary control. They are things that have to be worked out by other lines of activity and endeavor. I think that something can be done through national monetary and credit policies to help adjust our price levels within price groups; that, for instance, you can influence commodities with world markets easier than commodities without world markets. Sometimes by some broad action that would affect one or another of the groups you can accomplish something, but, generally speaking, I think those problems must be worked out by other methods. I don't quite see how the tools that are in the hands of the general monetary and fiscal authorities at the present time can go very far.

Question - Do you think the English system of depending on the bank rate is the most effective instrument that may be used and if that is available in times of depression like the one we have just been through?

Answer - I do not think that is any longer the British rule. I think you mean the system which was supposed to be the classical English point of view prior to the War. I think that the British are very much less willing to depend on that than they used to be. I don't think in

the existing circumstances in this country that this is of any consequence whatever. There are no discounts now and are none in prospect for some years to come, so we must of necessity use other instruments than that.

Question - I should like to raise the question of what instruments are available at such times.

Answer - It is rather difficult to say that in a few words, but it is true that we can have an influence on the availability of money through open market operations. We also have the power to raise or lower reserve requirements of banks, which has the same general effect of making more or less money freely available for the use of the public. We have powers of determining margin requirements on security loans which makes it possible to exert an influence on the amount of money that goes into the stock markets, and we have the power of determining the maximum rates on time deposits, which has an influence on the cost of money and the willingness to keep the money in the banks rather than invest it. There are numerous other instruments, none of which are absolutely effective at a period such as this, when there are three billions of dollars or more of reserves available to banks in excess of what the law requires.

Question - You said incidental to your statement that a proper objective of monetary control would be the utilization of production factors, that you thought that would bring with it a proper distribution of income, and I presume you meant in the particular conditions which might occur in the United States. I wondered whether I could ask whether you think that a monetary authority can have any effect through monetary control on the distribution of real wealth?

Answer - I should say that monetary authority as such would have but limited and indirect effect on distribution of wealth. I have said that that part of it would have to involve the cooperation of fiscal authorities. I would like to make it clearer. It isn't that the proper utilization of all factors would carry with it a proper distribution, because I do not believe that. But I do believe that a full utilization would not be possible unless a proper distribution of income was accomplished through whatever means it was brought about. I mean that you cannot have a continuous full utilization of resources unless you have a reasonably satisfactory distribution. As to what can be done to accomplish that distribution, -- the fiscal authority can do a good deal through taxation -- through the proper method and character of taxation. In fact it could not do it all. My own personal belief is that, along with taxation, we would have to have a great many other things in the way of social security legislation and minimum wage provisions, and in the way of gradually building a situation where every person could have an adequate income at all times, provided he is willing to work for it, and, if he isn't, there should be some arrangement by which those situations would be met.

Question - Isn't any monetary control or monetary curb rather inequitable and unjust, because it falls on the financially weak, and it doesn't necessarily follow that the financially weak are the least efficient producers?

Answer - I don't know that that necessarily does follow. I should think that one can conceive of a monetary control or supervision which would support the weak at the expense of the strong. I do not feel that it is necessary

for a monetary control to be a protector of the strong against the weak. I think it has been true that the traditional attitude of the monetary authority, taking it in a broad sense, has been one that has been more concerned with preservation of the strong than the weak, but I do not think it necessary follows in our application to conditions and courses of development here. I think that practically the whole financial machinery has functioned now for a couple of years for the purpose of protecting the weak, supporting and rebuilding weak structures, creating favorable rates for working capital loans, and protecting the small investors. I think the whole trend is in the direction of protecting the weak, maybe to a point where it will become very profitable to be weak.

Question - Is there any means by which the monetary authority can increase the velocity of circulation?

Answer - It is my opinion that they cannot directly. No. I think that is one of the limitations of the power of the authority. I think that to the extent that velocity can be affected, it can be affected through taxation rather than through direct monetary action. I am inclined to think anyway that the point is not to increase velocity in order to increase business, but to increase business and velocity will come.

Question - I note that a brokerage house may borrow more money on a given amount of security than a customer may borrow. Why was that so arranged?

Answer - That is a rather technical question. The principal point is that this privilege for the broker applies only in so far as the broker borrows in order to carry his customers and not in so far as he may borrow in order to speculate on his own account. For technical reasons, a broker who pledges the securities of many customers with a bank and may have to withdraw any of them at any time in order to deliver them to the customers, might find himself in a difficult position if the prices of securities had moved in an unfavorable way. It is for this reason that the cushion is permitted for the broker. Then, too, a loan to a broker is a better credit risk, because he has an establishment and he is right there, and no broker can take any chances of losing his credit, and usually customers are not in the aggregate so good a credit risk. Both from the point of view of credit risk and the necessity of the business, it is all right for the broker to receive greater credit than the private customers. From the point of view of volume of credit it is all right too, because of the fact that the volume of loans is controlled at the other end when the broker lends to the customer, so that it seems on all these grounds to be a fair way,

Question - Based on the assumption that the broker is not going to speculate for himself?

Answer - If he speculates for himself, he is not in a preferred position and must borrow on the same terms as anyone else.

Question - We have a very unusual situation in the history of this country. We have had the present depression for about seven years, now from early in 1929. We have still to go back farther to about 1925 or twelve years to get anything like 100 percent production. It is not only an unusual depression, but something that has never happened before in this nation or any other nation that I know of. It has been the thought that this cutting off of total production, which means unemployment for the employee and smaller production for the manufacturers, therefore

a great curtailment in our total social activity and utilization of our social resources, and it has been the thought of some that, if we could get our general price level up to something like it was in 1929, that might give us a stimulus. It seems that the Treasury and Congress had something like that in mind in demonetization of the locked up gold. But, since we are off the gold basis entirely, we can get no benefit from the demonetized gold dollar which is locked up and has no effect on money in circulation and no influence on the price level, so we can get nothing from that attempt. Is there any probability that this $10,000,000 will remain locked up from all the world and our people individually? Is staying off the gold basis the same as saying that we do not have any monetary control in this country? I do not understand it.

Answer - It is a rather big subject. I should say, because it is a big subject, that I think I will answer dogmatically and just give you my views in three or four sentences, and then you can disagree with me if you will.

The point in my opinion is that the location and circulation of the gold is of no consequence to any one, that the gold is merely a basis of credit. The important thing for the utilization of resources is that there should be always an adequate volume of means of payment available for such transactions as are needed, and whether that means of payment is in the form of gold, or silver, or greenbacks, or state bank notes, or checks is of no consequence. I do not believe that the revaluation of the gold was for the purpose of increasing the amount of available gold, nor do I think it makes any difference whether that gold is circulating or not. In fact, I think it is in the interests of the nation, broadly speaking, to keep that gold where it can serve as a basis without its finding its way into private hoards where it ceases to function. When it is a public hoard, it can serve as a basis of credit, so I think it is desirable to keep it there. Then too, there is no danger of its finding its way out of the country and thus being lost to the United States.

I do not think that there was any idea on the part of those who revalued the dollar that that might be a means of increasing the amount of gold available for public circulation. I think that those two views do not go together. I think they believe in using gold as a standard and not as a medium of exchange.

MONETARY CONTROL II

By

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In speaking to you this afternoon on the topic announced, viz., Monetary Control, I think it best at the outset to define terms, so that our minds will meet upon a common ground of consideration. Under the head of monetary control, I understand it is intended here to discuss the basis of legislation and of institutional organization which serves to direct the flow of purchasing power into the various channels through which it is dispersed to the various members of the community who have become entitled to it. This is the descriptive side of the problem. I presume it is appropriate to consider what changes, if any, may be made, or should be made, for the purpose of improving the access of the community to supplies of money and of regulating the condition, under which such money flows through the various channels of production and consumption and then returns to the general reservoir of purchasing power which the community has established.

In looking at this question, we do wisely if we, first of all, examine the historical side of it. The classical economists, and those who have followed their reasoning, originally regarded the supply of money as something which should be left to regulate itself, or, as some have expressed it, should be regarded as automatic. By this was meant that when a nation, after due consideration of all relevant factors, had determined upon a given unit or standard of money, it should leave the movement of that money free, - to be directed by competitive and cost conditions. Under such a regime, the supply of gold in the world was dependent ultimately upon the cost of producing the gold. When commodity prices became so high and wages so far advanced that in mining the total amount of wages and material costs required to produce an ounce of gold were larger, expressed in gold, than the coin which could be struck from an ounce of gold, - mining would obviously stop; while, conversely, if prices became so low as to leave a gold profit, - that is to say, to permit the mining and labor costs to be paid out of the gold product of the mine and yet leave a surplus, mining would be resumed. The control of money, if we may use such an expression with reference to the views of classical economists, was thus a control indirectly exerted by the community through its establishments of conditions that would raise or lower commodity prices. You will notice here certain very broad assumptions which underlie the discussion, as the or similar assumptions - naturally underlie all, or most of all, the classical economic doctrine. It is evidently taken for granted - as is taken for granted by so many superficial thinkers today, that all price react in about the same degree, to external factors, - that competition was fairly perfect and nearly universal; and that supplies of gold subject to mining were either reasonably constant or, at any rate, subject to fairly regularly increasing expenses. None of these assumptions was quite valid, even under the most favorable conditions and, accordingly, a good many of the later writers devoted themselves to examining "exceptions" or "limitations", upon the general notions affecting monetary production and supply. It should be added that the classical economists, like a good many of their successors, were disposed to devote themselves almost

entirely to an analysis of cost and production factors as affecting money, and to have very little to say on these points as affecting commodities.

But, this theory of money, if we may so call it, was early recognized as very incomplete and hence, it soon came to be supplemented by a theory of banking and of credit. The bank was never, contrary to hasty later assumptions, regarded by the classical economists as chiefly a mechanism for controlling or directing or conserving or saving money, but it was regarded as an institution whose mission it was to maintain a satisfactory relationship between the supply of money and the liabilities or bank obligations - later, indeed, the entire body of liabilities and obligations - which had been built up upon the monetary basis and, presumably, might constitute a call for money at any given time. Banking from this point of view thus became, with the classical economists, a study of the policies which banks must follow in order to keep themselves in position to meet demands upon them in terms of money. Their currency issues, and later their deposits, thus came to be regarded by some persons as "money substitutes". The classical economists did not so regard them, but, on the contrary, they treated deposits and checks as bank liabilities, stated in terms of money but actually cashable only to the extent ultimately that they were not offset by other indications of a similar sort, offsetting those that might otherwise be presented for cashing. In a certain sense, the policy of banks thus might be regarded, under the classical theory as the medium by which the supply of money was controlled. A bank which had incautiously built up too large a deposit line practically placed itself in a position in which it must attract more money to its vaults; - one which allowed its liabilities to "run off" placed itself in a position to part with portions of its supply of money. From the later standpoint of critical analysis of economic theory then, we might say that the so-called automatic system of money of the classicists was a system of money management or control in which the direction was afforded by banking institutions through their decision as to what supplementary supplies of commodities or exchange media were needed in their service to the community. Inasmuch as the bank, however public-spiritedly conducted, was always a profit-making institution, it might be said by a hostile critic, that the agency through which the control of money was to be exerted was directed by the profit motive, just as was and is true, of course, of every other undertaking in a capitalistic or profit-making society. Such a critic, however, if fair in his analysis, would also add that, in the long run success in carrying on banking along the lines thus indicated would be best attained by methods and policies that would bring about the greatest activity of business and the largest exchange of commodities possible.

Let us now glance for a moment at a contravening theory which, as I understand it, is favored by a number of members of the contemporary British school of writers on banking and monetary questions and by sundry imitators in the United States and other countries. According to these later writers, it is not necessarily desirable to have any monetary "standard" which is tied to or represented by a given commodity or group of commodities, but it is entirely possible and, indeed, ideally permissible to have a monetary standard which rests upon an imaginary unit of purchasing power representing an abstract conception, perhaps ultimately standing for and frequently part of the wealth of the community, as determined on some indicated basis. Now, according to this school of thinkers, the supply of money

should be unlimited, that is to say - the state should stand ready to provide actual tangible units of money or paper representatives thereof in such quantity as may be desired by any member of the community who has become entitled to them as the result of the earning of salaries, wages, or under a capitalistic system - earnings, profits, dividends, and the like. Such a supply of abstract units or their representatives, may be furnished either with or without the intervention of banks. Exactly how this would be done and how the volume of such money would be fixed does not seem to me to be clear, nor is there any consistent indication among those authorities whose works I have been able to consult on that point. They are clear that the older limitations upon the issuance of what was formerly called "money" have proven injurious and they are equally clear that the policy of banks in restricting the volume of their outstanding liabilities - notes and deposits - to the amounts which they themselves stand ready to convert on demand into money, is intolerable. Many of them still adhere to the notion that so long as such requirements exist, there is danger of a money monopoly or a "money trust", or that groups of persons may bring about what is called "deflation" or subject certain classes in the community to the risk of having to pay back a designated number of units of money to creditors, notwithstanding that this number of units represents a totally different amount of purchasing power as compared with that originally borrowed. The scope of my remarks this afternoon does not, as I understand it, call upon me to discuss these criticisms, but merely to recognize their existence and to ask, how they affect the general problem of monetary distribution and control. In dealing with the subject from that point of view, we need to glance at least at certain fundamentals of economic theory that are frequently neglected.

Among these fundamentals is, first, probably, the question too often neglected: What is the basic service that is rendered by money? So universal is the money concept in its application that it would be possible for us to furnish various answers to this question - all of which would, undoubtedly be correct - assuming the premises on which they rest. Money would rightly be said to be a means of rendering effective the division of labor and of bringing together the saver and user of capital; but from the point of view which we are now employing the fundamental service of money may be said to be that of determining the relative output of various kinds of goods. We think of money as accomplishing this end somewhat as follows: In a world in which division of labor is carried to a high point and in which the advancement of credit upon discountable paper is dependent upon the profit-making ability of the application for such credit, it is evident that the influence of money is to determine whether the given manufacturer shall produce more or less of the article in which he is specializing. Let us take, for example, the manufacturer of some highly specialized part of an automobile - an automobile "accessory" or part. It is evident that the manufacturer of these parts is not able to judge by any direct process the number of them that are needed by the community. He may statistically form an impression about that subject but the ultimate test is the extent to which he is able to sell his output at a profit to manufacturers of automobiles, who want to use them in the manufacture of completed machines.

Now, it is possible for the banking mechanism to keep the production within reasonable limits only by being constantly assured that the manufacturer is what is called "liquid", - that is to say, that he can in case of necessity, cash in his claims upon others and with their proceeds meet the claims of others upon himself, leaving him the net possessor of a

claim to money. Through the mechanism of banking, such a test may be constantly applied; and a non-partisan or detached administration of banking would presumably refuse credit to those who are over-produced or in danger of becoming so, or to those who are producing at an unduly high cost - hence unable to show a "black figure" balance sheet. We may thus say that the function of the bank in insisting that its customers shall always be able to liquidate, exemplifies and embodies the function of money in regulating the output of those classes of goods, the demand for which is not immediately tested by the requirements of consumption. In the last analysis, then, it is through determination of access to money that the banking system eventually fixes the output of goods and determines interconvertibility of money and commodities on a basis which is in effect a regulation of supply. In this sense we may speak of the control of money as being in a certain way effected by the action of the bank in granting and assigning credit, or, in other words, the right to demand money, among the different applications for it. Note carefully at this point that we have now left the field which the older classical economists included under the head of "money" and have entered the field which they designated as "credit". This is an important point and one which is frequently overlooked in contemporary discussion. It necessitates a brief reference to the theory of credit as formerly understood and as modified in current usage, though our time will permit only a passing reference to it.

Credit, as viewed by the succession of British writers and their imitators who molded British credit theory, was not a loan of money but was a guaranty of ability to match demand and supply of commodities with the understanding that the bank insured such convertibility or exchangeability under penalty of having to convert non-exchanged surpluses into immediate means of payment, or cash. The regulation of banking, as viewed by the succession of British writers of the latter half of the 19th century was designed to make sure that the bank itself was not only solvent but liquid; that is to say, that it had not assumed the liability involved in too many of such contracts of guaranty or insurance. The function of money thus involved was that of limiting the possibility of unduly extensive undertakings or of undertakings whose products could not, as things stood, probably be disposed of with success by their makers. Credit was thus a study of the conditions of production and of the probability that given fields of production could be matched against one another with success. Clearly, if some outside force suddenly began to operate in the direction of making money more abundant in the way, for example, that was indicated by Jevons in his "Investigations" or in the way that was recognized as possible through the issue of legal tender notes in time of distress, banks would be unable to gain access more easily to basic or legal tender money, and would thus be able to tolerate the existence of productive processes for which they might not otherwise find themselves able to furnish funds; in other words, which they would not be able to liquidate. We may say then, that the older economists viewed credit as the process of regulating the volume of claims to money and they viewed money as the ultimate medium by which these claims were tested.

Now, let us glance for a moment, in the same way, at some contemporary ideas on the subject. By identifying the conception of credit with the conception of money and by giving to money the popular definition "money

is what money does", as for example, was attempted by Congress when it bestowed the legal tender quality upon every sort of circulating medium, whether paper, silver, or whatnot (with the exception, of course, of checks), - many contemporary writers have washed out the finely developed lines of distinction which had been gradually drawn by generations of reasoners on the subject. The effect of their change of front in so doing is to bring them to the implied assumption that the control and direction of production previously regarded as exerted by banks must henceforth, according to them, be regarded as exerted by those who supply, or control the supply, of money; - hence the natural but unwarranted conclusion that a generous or liberal control of the money supply meant active production with correspondingly active employment, and resultant "good business". Implicit in this view of the situation, was the thought that with the community or society controlling the supply of money, no time would ever come at which restriction of that supply would develop or, to put the matter in popular language, - the prospect of what is called "deflation" would be accordingly deferred or perhaps eliminated. The real significance then, of the tendency noted in contemporary writing, to identify money and credit is found in the fact that this tendency principally means a discarding of the thought that private direction of credit is to be recognized or sanctioned as a means of regulating and adjusting different phases or elements of production, - one to another. It is necessarily admitted by almost all that some kind of regulation of this kind is essential. We cannot, for example, permit the existence of a chaotic world of production in which individuals produce goods of a specialized nature merely because the industrial arts and inventions have rendered some such goods cheap or easy to create. We do not want a world in which there is an enormous abundance, for example of automobile carburetors but a great scarcity of automobile tires, or a world in which there is a vast abundance, let us say, of rails for trackage but a great scarcity of cars or devices for carrying passengers over them. What we do want is a world in which the processes of production are rounded out and adjusted to one another in such a way as to insure complete acts of consumption - as many as possible in order that the greatest number of human wants may be kept satisfied. Eventually then, the controversy which is implied in the question, whether the separate recognition of credit is desirable, or whether we may consolidate our whole processes of reasoning under this head into a discussion of access to money, is reducible to the question, whether the past method of bringing about a supervision or adjustment of the sort to which I have referred, is about as effective and satisfactory a method as we can find.

Some may be inclined here to interpose the thought that it is really an inquiry as to whether the capitalistic system is the best system that can be devised and whether we should not get a better result under a system of planned economy; or they may be inclined to convert the question into an issue as to whether the recurrence of severe depression in business does not indicate the inefficiency and breaking down of the older system of regulating relative lines of production and insuring complete consumption as economic life proceeds. This, however, would be an unwarranted broadening of the base of our discussion. Let us assume for example, that we have a completely planned economy in which a central authority has all knowledge or wisdom and is able, in the last analysis, to determine how many pins and needles shall be produced each year and the proportion to be maintained between them and the number of buttons that are turned out. Under such a condition we

should still have to find some means of determining the actually desirable number of these individual commodities to be turned out. Planners could successfully apply their powers only when they were informed very definitely of the level of demand. No planner could be expected to anticipate the effect of changes of fashion or the adaptation of human tastes to various objects of consumption, nor could he in any case be expected to know how changes in the industrial arts or in the technique of invention would be likely to influence human disposition to buy. With the utmost of knowledge and the maximum of capacity on the part of the planner, it would be possible for him to direct the production of commodities only upon the basis of past demand - not of future. For the present purpose then our problem is greatly simplified and need not be made to include any such broad controversy as the problem of which we have spoken. There remains merely the question whether the present method of extending credit and of limiting it by requiring convertibility into money under certain conditions has, or has not been successful, - the degree of its success, and the question whether some better and more acceptable system can be substituted for it. These are the broad economic questions which grow out of the technical financial issue which we have raised.

From what has thus far been said, it will be clear that according to the present view, the desirable object to be attained in connection with the supply of money is that of rendering this supply such as to permit the exchange of commodities to occur with the least possible friction. This obviously does not mean the promotion of maximum business turnover or volume of business, regardless of its character or purpose. It does mean that the desirable condition for economic society is the fullest possible satisfaction of every demand, by the furnishing of a corresponding supply of each of the goods thus demanded, while at the same time and conversely, it implies that supply shall be carefully adjusted to demand, with the result of avoiding what is sometimes called over-production or maladjustment of production. The function of money should be that of permitting and facilitating this optimum exchange of goods to take place at the lowest cost and with the least friction. The suggestion, or assertion, that there is in the monetary or banking system as we have known it heretofore, an innate tendency to facilitate the production of certain goods or to retard the production of others, has no demonstrable basis, and in its support no convincing testimony has been adduced. It is, of course, an undoubted fact, that on many occasions in authentic economic history - indeed on some within our own recollection - the adjustment between money, credit, and the demand and supply of goods has been imperfectly maintained. In the majority of cases this imperfection has been due to one of three causes: (1) Erroneous information or judgment as to the volume of consumption and hence as to resulting values; (2) extraneous interference on the part of the public powers or of the state for the purpose of fulfilling objects dissociated from it, hence not regulated by strictly economic consideration, as e.g., war; (3) industrial changes and shifts growing out of alterations in the technique of manufacture or the type of industrial processes, as, for example, the invention of new mechanisms resulting in great changes in cost of production. Every process of human relationship, every functioning of machine industry is based upon and geared to some assumption of regularity, or, what the economists used to call "normality". Whenever such normality is disturbed

we have a disturbance of the economic relationships formerly existing, and in the case of which we are speaking we are likely to have a dislocation of the delicate adjustments which have been effected for the purpose of harmonizing demand and supply and the furnishing of exchange media to facilitate their relationship. That such disturbances are unhappy and have a bad effect goes without saying. That we ought to try to eliminate them and to bring about not only a restoration of what we call "normality" but of normality adjusted to the new conditions which have been brought about instead of to the old ones which have been displaced, is equally obvious.

In connection with the control of the money supply (under which for the moment I include also the credit supply), the best results are usually obtained through what is called by Professor Hayek, of the London School of Economics, a "neutral" condition of money, or an equilibrium. The present condition of social organization and the present state of knowledge of monetary principle does not permit the successful employment of artificial changes in the money or credit supply designed for the purpose of obtaining some non-monetary use or object. Like the inventor, who at times has sought to produce all-purpose objects which, for example, may in the case of overcoats serve a good use as fair weather garments yet be turned inside-out to supply a raincoat; or like those others that have designed instruments to furnish a composite instrument serving as a knife, fork, and spoon at the same time, we may eventually be able to work out a monetary method designed to furnish satisfactory media of exchange at the same time that they are used for the purpose of altering the distribution of wealth, or some other equally difficult object; but this has not as yet been done and, furthermore, it is a technique which cannot be hastily improvised. Through long years of experience we have developed a monetary technique or "control of money"if you will, which is designed for a specific purpose - that, namely, of facilitating the exchange of goods. To put this in another way, we have assumed that demand and supply are adjusted to one another as the result of human wants and that the function of money is to facilitate their working out; or, again, in other words, we have assigned to money the role of a servant whose duty it is to perform certain economic tasks. These tasks are of a fundamentally important character. They are not, however, tasks of direction or initiation designed for the control of economic purposes or objects. The assumption that they can be converted from one thing to the other, or that, by turning our monetary system inside-out, we can shift it from its original place, as a fair weather coat, into a new place in which it serves as a protection against storms, is an assumption without warrant.

Nothing of the kind can be done off-hand, and without lengthy premeditation and preparation. To attempt it merely causes confusion in the economic system, and makes the attainment of the object so sought more remote rather than nearer. In developing our control of money, we shall do well, first of all, to try to render our present system as perfect as possible and as free from the three main factors of disturbance, to which I have already referred, as conditions will permit. If we could thus improve and perfect it in these essential particulars, I do not hesitate to believe that we should find it on the whole sufficiently serviceable to meet present requirements, - certainly until the time comes for a very drastic regimentation of production and consumption such, perhaps, as has been tried (and abandoned) in Russia. Even if we assume the existence of such regimentation, a project of the kind

of which we are now speaking will involve very different methods and techniques as compared with those that are now in vogue or to which, today, the adjective "sound" (in place of which I should be inclined to substitute "feasible" or "beneficial"), is applied. For the immediate future, then, evolution in what may be called the "control of money" should be an evolution of the adapting and adjusting of supply of, and demand for, goods in such a way as to give the fullest and freest play to the supply and demand which result from present economic arrangements as sanctioned and recognized by law and custom. We should, indeed must, endeavor to see to it that the inevitable impeachments of banking judgment and hence of banking credit which grow out of extensive industrial reorganization shall produce as little disturbance as may be. To indicate how this may be done would require a much longer time than you have placed at my disposal this afternoon. The road to be followed is, however, clearly indicated by economic analysis and is not to be mistaken.

There is probably greater difficulty in readjusting the monetary mechanisn so as to be comparatively resistant to war disturbance with its resultant transformation of demand and its inevitable changes in conditions of supply of goods, and yet, the experience of the past twenty years or more has thrown upon this question light that was never before available and something at least can be done in the direction I have indicated; with the result that dangerous public finance, hazardous inflation with its conceded results upon the common man, and fictitious credit with its erroneous promises of relief from danger may be avoided. With regard to the disturbances of the money mechanism and hence with the money supply which grows out of erroneous measuring of banking credit with resultant assumption of undue risks and with consequent breakdown and failures, we are already making a considerable degree of progress, and this should be continued. The principal danger of interruption comes from the constant urging of public men that bankers should treat short-term credit as if it were long, and should use their short demand funds for the purpose of supplying consumption needs without prospect of early liquidation. Repression of such advice and further development of our credit testing mechanism may reasonably be expected to give us within a very short time a far more reliable system for the determination of bank credit, and for the measurement of financial risk than we have had in times past. There is ground for hoping that this more perfect mechanism for testing will also be accompanied by a similar reduction of interference, based upon political necessity, with the course of action indicated by careful banking judgment, to a point lower than has of late been the rule in several countries. If these expectations should be realized, even partially, a good deal of experimental or propaganda demand for a regime in which an unlimited supply of legal tender money is provided, will pass away. Such propaganda has always made its appearance in times of failure and inadequacy of existing credit and banking relationships. It represents a desire for something better than we have had, unfortunately not accompanied by a developed system for furnishing that betterment. The principal effect of it, then, is to demonstrate the evils of substituting theories and suggestions without giving them a permanent position in financial doctrine.

Nevertheless, as our conception of society advances and as the incidental evils which have grown out of competitive conditions are eliminated, we should do well to keep in mind the question, - how far the control of our money supply, with

its essential duty of adjusting production and consumption through insistence upon liquidity, can safely be relaxed. It is possible to see some points at which this relaxation may take place. One of them which may be mentioned purely as an example has been well developed in connection with the system of confirmed commercial credits and furnishes a striking instance of success in the mitigation of some of the harsher features of the older doctrines of banking control of credit. That other forward steps based upon the same principles so indicated may be taken when due preparation has been afforded, is entirely within reason; although the change will inevitably be gradual and probably accompanied by mistakes and modifications of plan. They will, as they should, for a long time constitute a staple of discussion in connection with the remodelling of our monetary mechanism. That mechanism has played an important and valuable part in the economic development of the world. It still has a fundamental function to perform. We should do wrong if we hastily circumscribed it or modified it through changes whose efficacy, or even whose feasibility, has not been demonstrated and which, upon trial, seem to make conditions worse rather than better.

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DISCUSSION

Leader - We have Dr. L. B. Curry of the Federal Reserve Board Research Department to lead the discussion of Dr. Willis' paper. Dr. Curry comes originally from Harvard and I am sure that we will all be interested in the views that he will bring to our attention in the questions that he may ask Dr. Willis.

Question - Dr. Curry - I take it my function is to open discussion. First of all I should like to state that I agree perfectly with Professor Willis' views that the monetary objective is the maximum production with the service of the right kind, and the utilization of the factors of production to its full degree. I can't visualize how his test of liquidity would achieve its end. I picture to myself fifteen thousand bankers applying this test of liquidity. I can see them looking back over their past records, and having it pointed out to them that brokers' loans have a very good record. It will also be pointed out to them that installment papers have had the very best records of any type of loan during the depression. It will also be pointed out that the line-of-credit loans, or credit loans, have been the types of loans in which the largest losses resulted.

Obviously then it is not liquidity; You have to be sure that the right type of goods are being produced and will be sold at a reasonable profit. That puts a hard task on the bankers. They have to become forecasters of public conditions. They say, "Well, a break may come some time, but we are on the upswing now. Profits are increasing. We can make a three-month loan and be perfectly all right." But your responsibility is not for the three months; your responsibility is this - will this situation increase the community's earnings, is it going to mean more profits, will it make your loans more liquid?

If you go that far you are getting pretty near to the point of view of the banks and their job - the job of the central bankers. This is not a job that can be left to individual bankers. Here the statistics will be better able to demonstrate to the authorities who are concerned with the broad flow of monetary income. They are the only people who can see the picture as a whole and decide upon whether further expenditure of money is justified at a particular time. They must be concerned with aggregates. And you must rely upon our profit system to correct individual situations. And there is,

surprisingly enough, a great deal of correction going on in our society.

If you recall the late 20's - that was a period of remarkably diverse business conditions. Some industries were expanding rapidly, like the automobile industries; capital was going into those industries. The banks had nothing to do with that - the automobile companies never borrowed from the banks. At least they did not supply the capital going into the building of motor car bodies. At the same time that was occurring, you had other industries - agriculture, boot and shoe, cotton textiles - where you had a pretty steady depression during that period.

I don't know if you recall the example of what happened after Lindbergh's flight to France. A great number of airplane companies started. That went on for about a year, and stopped. Stocks fell; by 1928 the flow of capital was completely shut off. The banks had nothing to do with that. I am not saying that is a good mechanism, but we must rely upon it. No individual bankers could have any control over that. The Federal Reserve Board could not have the instruments to control that situation. Our problem rather is to keep the broad stream of money incomes and expenditures going.

The incomes of communities are derived from disbursements of industries and Government. That income is available for the purchase of consumers' goods and, through savings, for the making of consumers' goods, and the production of producers' goods. And if things are going along smoothly, not going down very rapidly or up very rapidly, the rate of interest is of some effect, as the central authorities, through their control of the rate of interest, can influence the amount of investment, try to keep it in proper relation to the volume of savings of the community. This is a question to me quite apart from the individual banker's policy with regard to individual loans. As I visualize it, quite often the demands for loans vary inversely rather than directly.

I think the conditions under which commercial loan theory of banking would be successful are very difficult to justify. You would have to have all current production being financed by bank loans. You would have to have all those bank loans established. What would happen if you had an increase of goods at the beginning of the step? The money you are paying out would be available immediately for the purchase of consumers' goods. Once you start with a rise in price you are lost. You have a need for more loans. That is the leading question I would like to put to Professor Willis.

Answer - Mr. Chairman, I think I stated at the beginning that I would say very little indeed about banking, only as much as I though was essential to make the discussion clear. I would be the last man in the world to underestimate the influence of central banking or the good that can be accomplished by certain central banks. If one would go into the discussion of central banking, I think you would have to spend a rather long time. And yet I think I would say in reply that Dr. Curry offered an address, not a leading question, and I shall not extend an answer.

Dr. Curry - I considered I asked a leading question. I think the difficulty comes here - that I am one of those people guilty of commiting the crime of identifying money and credit. In my use of the term, money is credit. That is because I consider it an essential characteristic of the currency we have as purchasing power, that by means of which price contracts and debt contracts are settled by paying off in checks. I think you will agree that from that point of view it makes no difference

whether there is currency in your pocket or in your checking account. It makes no difference in the problems of the next few years whether individuals spend the currency more rapidly or check against the bank deposits more rapidly. They both offer a demand for goods.

Most of our incomes are paid in the forms of checks, and consequently when I was talking along the line I assumed that monetary control as used by many of the writers today means the control of this volume of the supply of checking accounts as well as currency; and I was concerned with the way of controlling that supply. I assumed that Dr. Willis' test of liquidity was a test really of the amount of bank assets which would determine the amount of bank liabilities, and the in-between amount of money. I don't know whether that gets us any closer together or not.

Answer - Not very much. The subject of credit control is a major principle of discussion. The question of how are we going to regulate the supply of money is quite different. The banks had ninety-day paper, and the fact that this paper was met by drawing a check on some other bank is neither here nor there. The question is to what extent would you have a complete clearance in terms of production and consumption. This is a purely incidental illustration of the discussion.

What a bank does is to test the productive quality of the credit and then extend it to a consumptive field with an ability to pay when the time comes for payment. It is a fact of course that in this country or in any country of commercial banking many mistakes in credit are made. The fact that you have a number of bankers who make mistakes and a number of others who unduly make mistakes on the basis of theory of credit has nothing to do with the matter. Central banking is the necessary balance sheet of control and offsets those things.

A general analysis and conception of credit which can be rightly applied should result in getting back this face of credit where expansion has taken place and of advancing or helping out others were the lack of credit is obvious. The result would bring about a new influence - if we would put this in our credit system apart from extraneous influence, political control, public finance - you would have to have a non-partisan bank. When you get that you find that you have to maintain clearance in the bank or liquidity - a term that I have employed this afternoon in the lecture that I gave at the beginning - liquidity as standing before a clearance of consumers' goods. It is absolutely the paper's condition which permits the continuance of that. If you destroy it, you are going to have a breakdown, a collapse, of banking.

Or you have a suspension of banking, as in 1933. You find that in such cases the bank has failed intentionally or through lack of political pressure or commercial pressure to assert the control of credit for which it was established.

I think that is a very brief explanation of the thought I had in connection with the control of bank credit.

Question from the Floor: As I understand it, I think you said in the talk one of the difficulties of the present situation, one of the principles you considered in connection with the world of money is that money cannot serve both as a medium of exchange and as the kind of money that it has served as during the era of our present monetary system, and at the same time as a means of regulating the distribution of wealth in our society. And I wonder if you would agree then that for similar reasons money cannot serve both as a medium of exchange and as a standard of value; that is, these have both been standard forms of money. In my own economic training and in the opinion of many, the inconsistency of serving these two

purposes has been brought home very strongly to many classes of American society in the past five years. I wonder if you would agree that perhaps these functions could be possibly explained.

Answer - In some qualification I should agree with that. Considerable progress is being made in that direction. If we go on defining our process of exchange we find some difficult things that have to be adjusted; the completeness of the process is, I think, not wholly feasible at the present moment. We are making some desirable steps in that direction, and I should say that the progress toward that end was to be expected.

Question from the Floor - I have heard a great many statements in the past few weeks in regard to a credit theory in the immediate inflationary movement and our supply in the consumption, also by a movement of land policy organizations. I wonder if you could explain to me where their fears arise?

Answer - At the opening of the talk I excused myself from any personal references.

Question from the Floor - Can you discuss the principle?

Answer - If I understood you correctly, you asked what I think is the prospect of inflation by the movement of some groups of bankers - the statement of fears of inflation. It seems to me that the bankers have been singularly undecided and unwilling to comment themselves on any.

Question from the Floor - One case is your own university discussion.

Answer - Will it be satisfactory to you if I explain my opinion on the theory?

It seems to me that the term inflation is one that has been badly abused and has been by most people at the present moment identified with the thought of rising commodity prices. 'You are going to have great inflation' seems to mean that you are going to have a sharp advance of prices of commodities. That popular use of the term inflation is of course, as you know, erroneous. The increasing of a supply of money and credit does not necessarily mean invested prices.

During 1929 and 1930 you had pretty stable prices, that is, after the general credit was over. In 1926 and 1929 you had almost stable prices. The same thing is true in other countries. We have to define our term inflation a great deal more carefully than is popularly customary now. If you are likely to have inflation in this country in that sense, in the sense of a rapid increase of commodity prices, what would you say has been the price level when at the present time it is something around 80 as compared to 60 in 1932. You have an advance of one-third of the level of 1932, which is no more than the recovery that has taken place in some other countries.

For the immediate purpose here there is no reason to expect a sharp advance in prices as far as one can see. On the other hand, a further distinction must be made between what is called inflation and the shifting of the money base, producing in the people's mind the feeling that the currency base is something different. You would have a large advance in commodity prices, because that would simply be the recognition of the public that you have come out to a definite kind of money base.

In that sense of the term I don't worry much about inflation. Let us look at inflation in another sense of the word. If we analyze it carefully we should find that it means that when the commodity goods have not been produced, people realize that the new increase of debt is going ahead very fast, not only in the public treasury but also in corporate work, and that we have a tremendous inflation on the

way in that connection. There can be no doubt whatever; it is simply obvious.
Question from the Floor - Is that the total volume of all credit?
Answer - We are getting a tremendous increase of credit and debt; that is to say, of values explained in terms of money. You can't meet it under existing conditions. That raises the question - will the inflationary effect of this over-increase of debt force a change in the money base? This is still to be determined. At the present moment, we are piling up against surplus reserve in the banks that is not being actively used. The business of the banks is slowly increasing, and generally speaking, we have an endeavor on the part of the community thus far to accustom itself to the use of the funds which are thus being placed at their disposal. It is apparently in a fair way to bringing us to the point where we have to change the relationship between our dollar and the values on which it is founded.

Have I answered your question frankly?
Question from the Floor - Now on the question of debt. All my neighbors are paying off their debts. The corporations have borrowed almost nothing for four years. It seems to me we have decreased it instead of increased it.
Answer - It does seem to me you can't prevent that. Governmental debt is the obligating one. You speak of paying off your debt - the amount of debt as adding to your income. How do you figure the states must pay their credit debt - and the three billion dollars of Federal debt States, cities, and schools are all adding to their outstanding community debt. As to the banks, if you look into their balance sheets you will find that they are much higher than they were in 1928. We are living in an era of greater creation of obligations.
Question from the Floor - Do you thin that this increase of credit will lea us to increased production and consumption?
Answer - We see no signs of it so far The index of the Federal Reserve Board as to the volume of production has notably risen with the past two years. So far as that goes it would seem that there has been some greater activity and production, but we may question whether the activity thus indicated means anything but a similar activity outside of a comparatively small number of industries which have taken action, and which are typical but not sufficiently indicative of the real conditions, to allow us to say that there is a larger amount of produced wealth available for consumption.

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I have decided to center my remarks very definitely about one proposition very important just now to an understanding of the relation of the government to agriculture. That one proposition is that, as I understand it, under our scheme of government, under our legal system as it is growing, evolving, being clarified in the light of particular concrete situations presented to the legislatures, both state and national, and to the courts, we have evolved to the point where it may now be said that our government has accepted the proposition that our economic well-being and social health are to be safeguarded under the "general welfare clause" of the Federal Constitution and under the police powers of the states. I think there has, within the last year or so, and particularly since the 6th of January, 1936, been a considerable clarification of that issue. I am inclined to think also that it is a little clearer in fact than it is in general popular appreciation.

So I am setting myself up as something of a seer, to try and probe into the inward truths of the situation, which go a little beyond, are a little more encouraging, than current understanding of the matter. This word or phrase "general welfare" or "safeguarding public welfare under the police power of the states" are not mere phrases, and they are not, I believe, in future to be limited to matters of safety, physical health, and public morals.

We have come to the explicit broadening of that view and have accepted a broad interpretation as part of the public policy, which makes the government a larger factor in our economic life. Several important decisions have stated this broader view with so much acumen, so much erudition, that I confidently predict that subsequent cases will follow the same line. An individual judge may kick back from time to time, but generally speaking, in important cases we shall find the high courts following the same line as that which has been laid down in these several important recent cases, and we shall find the doctrines becoming firmly established in our legal and governmental system.

The two lines of opinion to which I refer are, of course, those of the Supreme Court of the United States (a) upholding the New York State Milk Control Act, and (b) the other decision of that same court invalidating certain features of the Agricultural Adjustment Act. And on the other side the decision of the New York State Court of Appeals in a case, which was subsequently passed on and affirmed by the Supreme Court of the United States, and the recent - about two weeks ago - opinion of the Supreme Court of California in upholding the state pro-rate act.

I want to begin by quoting at enough length to really do justice to the argument of the court as it was stated in the Hoosac-Mills decision. The Court said: "The Congress is expressly empowered to lay taxes to provide for the general welfare...The necessary implication from the terms of the grant (of spending power) is that the public funds may be appropriated 'to provide for the general welfare of the United States'. These words cannot be meaningless, else they would not have been used. The conclusion must be that they were intended to limit and define the granted power to raise and to expend money". After reviewing the narrow Madisonian interpretation of the spending power con-

ferred on Congress by the Constitution and the broader interpretation which was enunciated by Hamilton and accepted by Mr. Justice Story, the court concluded "that the reading advocated by Mr. Justice Story is the correct one. While, therefore, the power to tax is not unlimited, its confines are set in the clause which confers it (where the phrase 'for the general welfare' occurs) and not in those of section 8, which bestow and define the legislative powers of the Congress. It results that the power of Congress to authorize expenditure of public moneys for public purposes is not limited by the direct grants of the legislative power found in the Constitution". The court referred to its own conclusion as "the adoption of the broader construction". To be sure, they expressly state: "We are not now required to ascertain the scope of the phrase 'general welfare of the United States', to determine whether an appropriation in aid of agriculture falls within it". On the other hand, what they said as to the limitation of the powers of taxation and appropriation was simply that they extended "only to matters of national as distinguished from local welfare" and that "every presumption is to be indulged in favor of faithful compliance by Congress with the mandates of the fundamental law". It was only "if the statute plainly violates the stated principle of the Constitution" that the court would so declare.

I, personally, can find nothing here - in these lines nor between them - which indicates that a measure honestly conceived to assist a large proportion of our farmers in getting back from wasteful and uneconomic practices of farming, induced by ill-conceived land laws or the absence of proper regulatory legislation and practically forced upon them by developments within the field of international commercial relations and domestic finance, and somewhat to socialize the burden of re-establishing practices which would conserve resources and assure an adequate development of the nation's agricultural industry in the future does not relate "to matters of national as distinguished from local welfare". I cannot see how the court which wrote the Hoosac Mills opinion could say that even a broad scheme of benefit payments designed to cushion the burden of technological and commercial readjustment in the agricultural industry, if not conditioned on production control, did not fall within its broad interpretation of the power of Congress to tax and appropriate "for the general welfare of the United States". It is obvious that few laws will apply comprehensively and uniformly to all classes of our population. But if they apply equitably to one of the major segments of our industrial system with which all the rest of the system is closely interarticulated, they would fall within the field of Congressional authority marked out by the United States Supreme Court in this opinion, if English words mean anything.

If I am right, the Court declared implicitly that Congress could appropriate public funds for such broad purposes as conserving the nation's natural resources or conserving its social resources in a large and important occupational group or in government services such as facilities for communication or education which related directly to this group but through them indirectly having important repercussions on the national life and welfare as a whole. What it said explicitly, however, was that in pursuing this legitimate goal of safeguarding the national welfare by ameliorating the condition of the agricultural class, it could not impose specific controls upon the manner in which agricultural production was carried on within the several states any more than it could alter the marriage and divorce code, the laws of private business, conditions of citizenship, or similar matters which

constitute the reserved rights of the sovereign states.

This view of the court seems to me both logically and historically correct, and, I may add, not unduly restrictive for the carrying on of the economic and social enterprises of this country. It is a distinctive feature of our federal government that in establishing the central authority it did not entirely abrogate the powers of the constituent commonwealths to regulate the political, economic, and social activities of their citizens. It was only because of this reservation of many, probably a majority of governmental powers, that it was possible to get the original group to federate for the purposes of establishing a national government which would have sufficient centralized strength and authority to exercise effectively the powers, chiefly diplomatic, military, and fiscal which were delegated to it, which were essential to the states, but which none of them could exercise effectively. With the passage of time those centralized powers have been somewhat enlarged and orderly, though slow, machinery for further enlargement through amendment is provided in the Constitution itself. It is my belief that with changes in economic conditions already realized or reasonably discernible in the future, we shall at no greatly distant time find it necessary and possible to make some further delegations of power to the federal government. But I believe that it will be better political science if these powers are for the regulation of particular functions such as limitation of child labor or enlargement of the interstate commerce power rather than the right to control whole industries or branches of business.

The doctrine of inviolable states rights within an indissoluble federal union was the unique and basic principle upon which the nation was formed. In defense of this principle, we later waged a bloody and costly civil war and I believe that in spite of any irritation we may feel at the retardation of certain of our most dearly cherished plans of social and economic reform, because of the limitations of that constitutional system, I think we should honorably try to observe them rather than attempt to break them down by schemes of indirection. Centralization has its dangers as well as its advantages and one need not be branded a Tory because he advocates making haste in this direction somewhat slowly.

So much for the Federal aspect of the matter. It is very incomplete unless we turn to the State side of it. Some people have been very deeply concerned about the implications of the doctrine annunciated in the Hoosac Mills case, feeling it necessary to get Federal action because of their fear that the States would or would not adopt a sufficiently broad view. I call your attention, therefore, to the fact that the Supreme Court of California very recently upheld the State Agricultural Prorate Act in an opinion which sweepingly accepted the duty of regulating the process of agriculture and the production within the State as something which falls within the broad interpretation of police power which is gaining vogue.

Quoting from that opinion:

"The courts of this state have had frequent occasion to expound the law applicable to the proper exercise of the police power of the state. In a recent case we held that under that power a city by ordinance could establish districts or zones within its boundaries, and limit the uses to which property located in these several zones could be put by the individual owner. As marking the development and growth of the police power the court in that case said, 'In its inception the police power was closely concerned with the preservation of the public peace,

safety, morals, and health without specific regard for the 'general welfare'. The increasing complexity of our civilization and institutions later gave rise to cases wherein the promotion of the public welfare was held by the courts to be a legitimate object for the exercise of the police power. As our civic life has developed so has the definition of 'public welfare' until it has been held to embrace regulations 'to promote the economic welfare, public convenience and general prosperity of the community...' The principles governing the exercise of this high prerogative of sovereignty have now been so well established and so universally recognized that we will end the discussion of the subject by reference to a few recent cases principally from the Supreme Court of the United States." The Supreme Court in upholding certain State Statutes has accepted that broad interpretation. This is particularly true in the Nebbia case, the State case, the New York Milk Control law/upheld by their own State Courts but appealed to the United States Supreme Court and there reaffirmed.

Incidentally, while I was in Southern California a few weeks ago, the chief of the group that had had this State Pro-rate Act, as relating to lemons, up in the Supreme Court and had it there decided, said if it was upheld, they would exert every opportunity to get it to the United States Supreme Court. I think they have the money, so we shall probably have an opportunity to see what the Supreme Court thinks on this matter in a little different light - that is, the issue being a little different from that in the milk case - but you see what the same Court will say after it said what it did to Mr. Butler and the other members of the Hoosac Mills group - the principal discussion in this California Supreme Court decision related to what the United States Supreme Court had said in its affirmation of the State Court's action upholding the Milk Control Act.

Quoting first from the decision taken by the New York State Court of Appeals, in upholding this before it came to the Supreme Court of the United States, the New York Court said:

"Doubtless the statute before us would be condemned by an earlier generation as a temerarious interference with the rights of property and contract, with the natural law of supply and demand. But we must not fail to consider that the police power is the least limitable of the powers of government and that it extends to all the great public needs; that constitutional law is a progressive science; that statutes aiming to establish a standard of social justice, to conform the law to the accepted standards of the community, to stimulate the production of a vital food product by fixing living standards of prices for the producer, are to be interpreted with that degree of liberality which is essential to the attainment of the end in view and that mere novelty is no objection to legislation..."

That is what the Court of Appeals of New York said and what they brought to Washington to see if the Supreme Court of the United States would detect an error in their reasoning or take exception to it. The Supreme Court of the United States accepted this view, that demoralization of the milk business was detrimental to the community and they upheld the New York law. All of this was taken into account by the California Court in its favorable opinion of the State Pro-rate Act and then they stated their final decision in the following paragraphs:

The concluding statement of the California court was as follows:

"We do not feel that we are in any way or to any extent extending the principles of law enunciated in the authorities cited above by holding that such a business is so affected with a public interest or

clothed with a public used as to justify the state in the exercise of its police power to impose such reasonable regulations upon the quantity of the commodity that may be produced and marketed therein as will save the industry from destruction from ruthless competition, the direct effect of overproduction. The restraint imposed by the statute operates only upon the quantity to be produced, and the amount to be marketed. After securing the secondary certificate permitting the marketing of his proportionate amount of lemons produced, the lemon grower is then left free to sell such amount at whatever price he may receive and to whomsoever may desire to purchase the same. The limitation simply limits the amount to be marketed and does not extend to or affect the sale of the commodity. As before stated, the terms of the act apply equally upon all growers and distributes the benefits and burdens among them in proportion to the amount of fruit produced by them. The act is therefore neither arbitrary nor discriminatory. It cannot be said that any person affected thereby is denied the equal protection of the law."

Those statements - through every legal opinion, to my mind, established the proposition which I enunciated at the beginning, namely, that it is the function of government to do those things for and with agriculture which are necessary for maintaining the health of that industry and, through it as an integrally indispensable and total part of the economic structure, maintaining the general welfare of the United States. That has been clearly established.

A second thing has been made clear - namely, that the Federal Government can presumably do everything with reference to a statute of that sort except as it constitutes an invasion of the reserved powers of the Sovereign State not specifically granted under our federated type of Government, but that does not mean the necessity of going back to anything like "horse and buggy days" or a condition of laissez faire in economics. Even in the case of the Federal Government, if the whole of the Agricultural Adjustment Act had been stricken out, it would still fall very far short of putting us back to the condition of laissez faire in economics with reference to agriculture.

We have had for a long time a very effective system of services, guidance, and aid on behalf of agriculture, without the processing tax and production contract device. I am inclined to feel that that device was distinctly helpful during the period that it was permitted to operate, but I am not at all cast down as to the possibilities of the kind of public service on behalf of agriculture that Government could render even without processing taxes. The second step, however, that the opinion clearly upholds, is the power to levy excise taxes or processing taxes, or other forms of excise tax, making it clearly possible for it to exercise the spending power in behalf of ameliorating agencies, activities for agriculture which would go far beyond anything that we had prior to the passage of the Adjustment Act. So the amount of ground which is lost, as I interpret it, is comparatively slight and is ground which is denied them simply because it is technically occupied by state governments. The only question, as I see it, then, is as to how many states will occupy and codify that field within their sovereign rights as states with the vigor that New York has exercised it not only in the Milk Control Act but in its policy of building up a set of regulations, and not only New York, but other states which have conducted agricultural activities which have a distinctly improving influence on the conduct of agriculture in those states, or with the vigor that California has exercised under its State Pro-rate Law, a little A.A.A.

law, its four milk laws and quite a number of others.

There is no question in my mind of the adequacy and the skill with which that process is being carried on in pace-making, leading states, such as California. The question which, it seems to me, remains, is whether there may not be in certain states, whether through lack of interest or unwillingness to bear the burden, or whatever it may be, to develop this field, a disinclination to complement the field of activity still open to the Federal Government, and in my judgment sure to be cultivated more aggressively in the future even than it has been in the past. States will have only themselves to blame if they fail to cultivate the field which the general trend of statute and case law clearly indicates is within their reach if they want to exercise it.

We know, however, that there are difficulties. In some cases the magnitude of problems within a given state are rather disproportionate to its ability to carry on an aggressive program even if it is desired to do so and even if the state has the vision to see it. So I am inclined to think along with the optimistic view which I have been consciously enunciating here as to the future field of government activity with reference to agriculture, the weak spot which we must recognize is that of getting certain states within our Federal system to find ways of cultivating that field which is reserved to them and which I think we can clearly foresee will demand cultivation for quite a number of year ahead.

POWER AND ITS SOCIAL CONTROL

By
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I. THE ECONOMIC POSITION OF THE ELECTRIC UTILITY INDUSTRY -

In the course of 54 years, the electrical industry in the United States has grown from the single small generating station which Thomas Edison built on Pearl Street, New York City, to a point where it now claims an investment of 13 billion dollars. This has really been a remarkable achievement springing from the combined efforts of scientists, engineers and business men. Up to 1930, the activities of this industry were progressing at such a rate that scarcely a month passed without the establishment of a new record in the capacity of electric generating units. At the State Line plant on the southern shore of Lake Michigan a single unit was installed of a size sufficient to meet the needs of a community of a half million persons. The same sort of progress has been made in the art of transmission until today we have a 285,000 volt line extending from Boulder Dam 271 miles to the City of Los Angeles, with copper conductors the size of a one-inch pipe.

It may be said to the credit of the electrical industry that no other industry has as effectively and completely adapted power to its own service. Electric generating systems have an automatism and foolproofness which is unsurpassed in industry. This control has worked so perfectly that we rarely are forced to note the importance which electricity plays in our daily life. When an unfortunate combination of circumstances does occur and a major breakdown of the supply system results, we have an opportunity to observe, which is as rare as the astronomer's chance to train his

A highly congested section of New York City was so eclipsed a few months ago. This spectacular interruption of service gave a vivid lesson to millions of people on the relationship of electric current to the life of the city, and at the same time a reassuring proof of the patience, adaptability and sensible behavior of American crowds suddenly deprived of their accustomed safeguards by a mechanical accident. At 4:16 p.m. on an afternoon of pouring rain, a main switch "exploded" in the New York Edison Company's plant at 132d Street, the second largest power plant in the world. The accident set off secondary troubles all over the northern half of Manhattan and the Bronx. Transformers burned up, manhole covers were blown off by gas explosions, and in a few minutes practically all alternating current activity had been stopped.

At the time of the accident the subways were crowded with home-ward-bound office workers and shoppers, and more were arriving constantly. Within an hour they had reached a high state of confusion. The Eighth Avenue line was out of service with 60,000 people caught in stalled trains; the other lines were so jammed that at Times Square the people could neither get off nor on the cars. At 103d Street, the electric pumps used for draining a low place in the express track were out of action, and the water rose to such a height that the express trains could not get past. Police warned the spectators in Madison Square Garden not to attempt to get home by the disabled subway. It is remarkable that the only reported disorder was the case of one man who was arrested for yelling defiance at the subway for re-

On upper Fifth Avenue the only lights were the headlights of automobiles and the red tail lights, reflected in the wet streets, with here and there a solitary building which was lucky enough to have its private electric plant. In a big department store the sales force was directed to get flashlights and candles from the counters on the fourth floor. All the elevators and escalators had stopped, but the employees were able to get up the stairs in the dark. The entire stock of flashlights and thousands of candles were used to light the store. The management commented on the remarkable confidence and calm shown by the customers.

Within a few minutes after the accident, men were going from house to house peddling candles. It is a curious fact that the great city in which no one has seriously used candles for lighting for fifty years or more had a large stock of them at hand when the need arose. The habit of using candles on the dinner table was a fortunate circumstance. In one hospital, where a six year old boy was being given oxygen for pneumonia, no candles were to be found in a hurry. For an hour the doctors read gauges by lighting matches, before someone discovered a flashlight. An emergency gall-bladder operation was performed by candlelight supplemented by a flashlight borrowed from a plumber who happened to be working in the building.

The guests of apartment hotels arriving home found the elevators all stopped. The electric clocks had stopped, the lights were out. Some of those with good heart-action walked up to their apartments, as far up as the thirty-fifth floor. Bell boys were sent up the stairs with candles for the guests who were marooned on the upper floors.

Eighty thousand people were in movie theatres when the voices of the actors trailed gradually off into silence and the pictures died away into darkness. There was practically no disorder; the managers offered the audience refunds or passes to future performances, and they marched out in orderly fashion.

The police teletype and radio system in the Bronx were both out of commission. Radio messages were sent through the station in lower Manhattan. Seven exchanges of the New York Telephone Company were stopped for about a minute before the emergency power plants were brought into play.

The picture I have just given portrays electricity as a convenience commodity. Even more important, though less directly felt by many of us, is the part which electricity plays in industry. It is indisputable that the application of electricity is having as much influence in changing our social order as the introduction of the factory system and the development of the modern corporation had on the economic life of the past century.

This electrical development is merely the latest stage in the evolution of the application of power to industry. In the period just preceding, the invention of the steam engine had made possible the conversion of heat energy into mechanical energy. The steam engine was, and even in its most refined state today still is, a bulky, cumbrous machine with tremendous power, but relatively difficult to manage. Now to the shaft of the steam engine has been connected an electrical device - the electric generator - for converting mechanical energy into electrical energy. This electrical twist has given to the steam engine a nervous system; it has retained the power of steam and into it incorporated divisibility, sensitivity to control, and most important — remote control, sometimes operating through great distances.

These refinements of power application have only raised to a higher degree the economic problems which the

steam engine had already introduced by facilitating and accelerating the displacement of manual labor. While this displacement of manual labor is still going on apace, creation of the photo-electric cell has introduced a new force into our industrial order which may ultimately, through its superhuman precision and accuracy, displace skilled labor in the same measure that manual labor has lost ground. This brings us to the edge of that realm of conjecture into which I do not propose to enter, but I shall give you the perspective which Edison expressed shortly before his death.

> "..... I am an old man now. I have lived to see the street car, the elevator, the electrified railroad, the automobile, the phonograph, the motion picture, the radio, the airplane, and the beginning of television. It seems today to many, as it seemed to most men and women in 1882, that no great forward steps remain to be taken.
>
> "It may be that the next forty years will not produce inventions of such revolutionary character. Progress has been so rapid that we may require a breathing spell in which to consolidate our gains, and develop present inventions to their full capacity. But of one thing I am more positive than I was even forty years ago - the electrical development of America has only well begun."

If you have a further interest in these social and economic aspects of the power problem, I recommend to you a book by Fred Henderson entitled "The Economic Consequences of Power Production."

On the other hand, electricity has much to offer in the reconstruction and realignment of our social and economic forces. I shall have more to say about this later on in discussing the activities of the Federal Government in the field of power and in the use of electricity as a coordinating factor in our national planning. For the moment I should like to examine with you some of the economic characteristics of electricity as a commodity.

Electricity is the most perishable of commodities. It must be marketed at the instant it is produced. We have not yet found a satisfactory means for storing electricity in large quantities. Consequently, the productive equipment - the boilers, turbines, generators and distribution facilities -- must be built to a capacity which will meet the maximum demand in the market at any given instant.

The soap industry by forecasting its demand can adjust its plant capacity so that there is a minimum of idle productive equipment. For the electrical industry to achieve this end, it would be necessary for one of two conditions to exist. Either all electrical appliances would need to be operated continuously - the absurdity of this is apparent when we consider burning our street lights when the sun is bright, or running empty street cars through the night -- or maximum plant output could be attained by staggering the use of appliances so that we have a uniform demand at all times. This latter condition of staggered use is the ideal toward which the electric utility business strives. If this condition could be realized the average demand would be 100 percent of the maximum demand. To use a technical expression, the load factor would be 100.

These peculiarities complicate the problem of rate making - or of determining fair prices within each customer class. When the industry was very young, English engineers set down the principles which govern scientific rate making. Their

analysis demonstrated the two essential components of the cost of electric service. First, there are the constant costs - interest, depreciation, taxes - and, second, the variable costs, the most important of which, in steam plants, is fuel. This classification of costs makes possible a fairly accurate assessment of each consumer's responsibility in the load of the system by the use of a two-part rate, consisting of a demand charge and an energy charge. In Norway, where all electricity is generated by falling water, the fuel component of the rate, being nil, drops out and a one-part rate is in use based on maximum demand alone. In large power contracts the two-part principle is rigorously applied with additional refinements to insure against variations in relatively minor costs. But for the small domestic consumer, experience has taught that a simple, clearly understandable rate structure with an average demand assumed is most conducive to generous use of electricity.

Let us turn for a moment to the development of the corporate structure of the electric utility industry. There were in the United States in 1902 3,600 privately and publicly owned electric supply establishments. By the time of America's entrance into the World War, the number of establishments had increased to 6,500. Following the War, however, through a period of mergers and consolidations the number decreased so that today there are approximately 1,600 privately owned and 1,900 municipally owned electric utilities operating in this country.

Early in the development of the American utility industry strong financial interests began to concentrate in their hands the control of utility operating properties. This was in part a result of the necessity at that time for manufacturing companies to finance the sale of their own products. The General Electric Company was probably the most notable owner of operating company securities. In the early twenties this company transferred its holdings in operating utilities to another corporation. By 1924 the Insull system had come to control nearly one-tenth of the industry. At that time 64 percent of the total energy was generated by operating companies which were part of a holding company system, whereas by 1929 this concentration had increased to 82 percent. The change indicated between these two periods marks a highly significant trend in the concentration of control and in the separation of control from ownership within these vast utility empires by a pyramiding process.

It is this gigantic machine which a handful of public guardians are charged with holding in check through the channels of public control. The legal principle of the right of public authorities to regulate enterprises which are clothed with a public interest dates back to the common law of the Middle Ages. In those days wharves, mills and common carriers were closely regulated. Doctors, tailors and innkeepers came under the surveillance of public authorities. Thus, regulation in the public interest is no new concept. As our society changes, new institutions appear to serve the public and new instruments are devised to keep and hold them within the bounds of the public interest.

There are a great number of somewhat technical factors which favor monopoly operation of electric utilities. Accepting the monopoly principle on technical grounds, both economic and engineering, the public must not be left to its mercy. If the monopoly is to be operated by private interests

it must be regulated by public authority. Since 95 percent of our present-day electric industry is privately owned, we have a major problem of regulation on our hands.

The basis of regulation is the police power of the government. The farthest reach of regulation is limited by the due-process clause of the Constitution. Between these limits units of government have sought with varying degrees of success to replace competition with a regulating mechanism.

State legislatures have delegated their powers for the regulation of public utilities to commissions. The general intent of these bodies has been to limit the return on the value of the property. The procedure has been to assign a fair value to the property, usually by means of two principles. One is the reproduction cost principle, which requires that the value for rate making purposes correspond to the replacement cost less depreciation. During periods of high construction costs this principle favors private investment by inflating the value of assets. The other principle of valuation is that of original cost - sometimes referred to as prudent investment. In periods of low construction costs the utilities are prone to urge this principle upon commissions and courts in order to prevent deflation of the value of assets. The Supreme Court has not yet clearly defined to what extent principle is to be applied. The majority of the Court has in recent years leaned decidedly toward the reproduction principle with the minority dissenting sharply. Many students of the problem are outspoken in their condemnation of the reproduction cost theory. Robert L. Hale has placed the indictment succintly in charging that the assumed sanctity and certainty of this theory are the consequence of loose reasoning, and that it "serves merely to divert the time, attention, and funds of regulating bodies out of the proper channels into one of the most unreal fields of speculation in which the minds of metaphysicians have disported themselves since the days of medieval schoolmen." Cost-finding required for managerial purposes is impossible with unit prices varying constantly as they necessarily must under the reproduction theory. Further, without the ability to determine costs with a fair degree of accuracy, regulation in the long run will prove ineffective.

Without clear cut legal dicta the commissions have been seriously handicapped. At the fork of the road the signs have been confusing. Other extraneous matters such as insufficient personnel, lack of appropriations and the absence of control over interstate operations have contributed to the inefficacy of commission control. These obstacles have thwarted earnest efforts to protect the public's interests even by some of our most able commissioners But perhaps as serious a factor as any which has cast its shadows over the commissions has been the judicial attitude which they have assumed. Rather than championing the public cause, they have sat as mediators. Before this court we have on the one side the highly paid and deftly prepared expert testimony of the utilities and on the other side little more than the stark complaints of the consumers.

Popular criticism of the utility industry in its treatment of the public may be divided into two phases. First, there are countless ways in which the utilities have successfully evaded regulation and exacted undue gains that are ultimately paid as higher charges by the electricity consumer or suffered as losses by the investor in utility securities. The second point of irritation is the economic philosophy of high unit charges and low customer consumption which has pervaded rate making for

domestic and small commercial power. This theory may have been justifiable in the experimental period when risk was relatively high. But such theory is now untenable in an industry which has acquired a stability and security of income which is paralleled by few, if any, other industries. The time has come when in the interest of the public welfare the converse theory - low unit charges and high customer consumption - must be put into practice.

With state commissions hampered by confusing court opinions, by the pressure of powerful financial groups and by their limited jurisdiction, assistance from the Federal Government appeared essential if the system of private ownership under regulation was to survive.

II. PARTICIPATION OF FEDERAL GOVERNMENT IN CONTROL -

The first Federal recognition of the power regulation problem came in 1920 with the creation of the Federal Power Commission as prescribed by the Federal Water Power Act. Under the provisions of the Act the Commission is to examine applications for the construction of hydro-electric developments on navigable streams and on public lands. The Commission, as it was originally set up, comprised three ex-officio members from the President's Cabinet. The Commission in its early days limited its action largely to such rather perfunctory matters as the issuance of permits and licenses for developing water power sites. The Commission had existed in this rather passive state for ten years when, in 1930, it was reorganized and five appointive commissioners were substituted for the three department heads.

The first real move by the Federal Power Commission toward aiding electric utility regulation on a broad national basis came in 1933 with the inception of two surveys, one an inquiry into the power production facilities of the country and the other a comprehensive analysis of rates charged by electric utilities. Both of these surveys - the National Power Survey and the Electric Rate Survey - have already published interim reports which have brought to public attention (1) deficiencies and surpluses in the generating capacity in various sections of the country and (2) the many inequalities and abnormalities in electric rates. Further fact-revealing reports are expected to give an even more complete picture of the industry and its rate practices. A special study is being made of the cost of distribution -- that phase of the industry beyond generation and transmission -- which has heretofore been little understood.

During the decade 1920 to 1930, control of utility properties was becoming highly concentrated through the pyramiding of holding companies. Reports of the Federal Trade Commission reveal that powerful financial interests, unbridled by the ordinary checks of corporate organization, were perpetrating many socially undesirable transactions under the cover of an almost impenetrable maze of corporate structures. Property values were inflated by write-ups to such an extent that they could not possibly be supported by any reasonable estimate of potential earnings. Fantastic bonuses and other excessive remunerations for service were paid utility officials. Watered securities were issued and sold to an unsuspecting public as the weight of this corporate dead wood strained to the breaking point. Loans were negotiated "upstream" from operating companies to parent companies rather than in the reverse direction. Struck by the collapse of the stock market in 1929 this house of cards toppled with far reaching reverberations.

In striking contrast to the heavy mortality rate of holding companies is the record of the electric operating companies from 1929 to 1935 inclusive. There has not been one important electric operating company failure! In spite of the heavy debt burden that these operating companies bear they have come through the depression years practically unscathed, and many of them are in a stronger financial position today than they were in 1929.

The terms upon which these operating companies have been able to borrow funds within the past year are evidence of this underlying strength. Loans for terms of twenty-five and thirty years have been made on a three and one-quarter per cent basis. The steady flow of revenue in good times and bad from their twenty million domestic customers has protected these companies from the losses suffered by so many railway and industrial enterprises. Since 1929 domestic consumption of electricity has increased over 40 percent.

The irresponsible activities of holding companies have been abetted by the absence of control over the interstate activities of utility companies. The jurisdiction of individual state commissions was of insufficient breadth to cope with corporate organisms which were spreading themselves octopus-like over wide areas of the country and embracing many states in a single system. Obviously action of the central government was required to bring these powerful corporations within the bounds of the public interest.

During the past eight years the Federal Trade Commission has been investigating the public relations and financial structures of these holding companies. In the course of this probing, which is now being concluded, a great mass of evidence has been produced. Published in some 60,000 pages, this evidence has left no doubt of the urgent need for Federal regulation.

Public indignation resulted in the passage by Congress of the Public Utility Act of 1935 over the bitter protest and acrimonious opposition of the utility defenders. This Act was drafted with close reference to the irregularities uncovered by the investigations of the Federal Trade Commission. But the constitutionality of the Act is now being challenged and a large group of holding companies refuse to comply with its provisions until its constitutionality is decided by the Supreme Court.

Under the new Act authority is vested in the Securities and Exchange Commission (SEC), which was created in 1934, to regulate certain aspects of public utility holding companies. The basic control device which is used in the Act is that of requiring those companies which are interstate in character to register with SEC. Companies which fail to register are denied the instrumentalities of interstate commerce to carry on their business. Registered companies are required to file with the SEC information pertaining to the structure of their systems and the scope of their activities. The SEC is directed to examine all security issues of registered companies. Issues which do not meet the standards of soundness and fairness prescribed in the Act are to be stopped.

The most controverted section of the Act is that which provides for, first, the voluntary (after January 1, 1936) and later, the mandatory (after January 1, 1938) simplification of the corporate structure of holding companies. Simplification means the reduction of a widely scattered holding company system to one comprising a geographically integrated operating area. Over the exchange and disposition of securities which will be necessary to effect this requirement of the Act, the SEC will have complete supervision. Un-

necessary construction and management subsidiaries - a favorite device for slipping fabulous profits out of the back door - are to be eliminated, and charges are to be kept within the limits of cost. Intercorporate relations of those remaining are to be strictly controlled. A system of "mutual service companies" whereby the holding units may retain the benefits of large scale servicing, construction and sales is suggested by the Act. Strict regulations are placed on intercompany transactions involving loans, payment of dividends, redemption of securities, and disposition of utility plants and securities. Uniform accounting methods are provided for, and companies are held liable for misleading statements.

Provisions of this Act were written to supplement and reinforce state public utility regulation rather than in any way to supplant it. The SEC is instructed to make investigations at the request of state commissions and to supply them with the results of special studies.

Title II of the Act empowers the Federal Power Commission to regulate the wholesale rates for energy flowing across state boundaries and to control the services, practices and facilities of power companies in interstate transmission. This brings under control certain abused liberties which have been beyond the jurisdiction of state regulatory bodies and so strengthens the state commissions' position. A precedent for this type of interstate regulation is found in the Interstate Commerce Commission which was created in 1887 to regulate common carriers.

At the same time that corrective measures are being applied to the electric utility regulatory machinery of the country, a movement toward the conservation and more rational use of the abundant water resources of the nation has been started. Such activity has been incorporated in the public works program directed toward the relief of the unemployment situation and the restoration of purchasing power.

Under the PWA preference has been given to certain classes of projects, one of which is electric power developments. The principal function of the PWA has been to make financial advances after careful examination of the feasibility of projects which have been submitted.

Financial assistance has been given to non-Federal applicants by way of grants of from 30 to 45 percent of the cost of the work, with the option of a secured loan for the balance. These terms have attracted numerous applications from municipalities seeking to build electric supply systems, some of which would compete with privately owned systems. In many instances the threat of competition from a publicly owned plant induced operating companies to make substantial reductions in rates. Not only in the localities where agitation arose but throughout the country the potentiality of competition probably has been a contributing factor to reductions in rates.

The greater part of PWA financial advances to power projects have been made to aid works which will be owned by the Federal Government. The completion of Boulder Dam, now being constructed by the Federal Bureau of Reclamation at a cost of $115,000,000, is made possible by such assistance. This massive structure is an example of the multiple-purpose type of dam which, because of its widespread and often unassessable social and economic benefits, falls to the lot of the Government to construct. This dam provides a water supply for Los Angeles and its environs, stores water for irrigation in the Imperial Valley of Southern California, releases water into the hydro-electric

turbines of both public and private electric systems, and provides extra storage space for flood waters. The ultimate capacity of the sixteen turbines at the base of Boulder Dam exceeds one million eight hundred thousand horsepower and is greater than the aggregate capacity of the 2700 hydro turbines which existed in the United States in 1907.

Several other Federal multiple-purpose dams are now under construction. One of these, Bonneville Dam on the Columbia River, is being constructed under the supervision of the Corps of Engineers of the United States Army to improve navigation and to develop power. Also on the Columbia River is the Grand Coulee Dam, being built by the Bureau of Reclamation as a combined power-irrigation development. A mountainous earthwork barricade is being raised in the upper reaches of the Missouri River at Fort Peck in an effort to control flood waters and aid navigation. Power generation here is of a secondary nature. The ultimate installed hydroelectric capacity planned for these three dams is nearly one and one-half million kilowatts. Such are the efforts of the Federal Government to utilize rationally the country's white-coal resources.

For the purpose of effecting the comprehensive development of the resources of the Tennessee River Basin, Congress, in May 1933, created the Tennessee Valley Authority (TVA). Among three directors appointed by the President is allocated the administrative responsibility of the Authority. To one of these directors is assigned the bulk of the electric power problems which come within the jurisdiction of TVA.

The Tennessee Valley abounds in water power potentialities. The program of the TVA, which is already well advanced, undertakes not only to develop the power potentialities in conjunction with navigation improvement and flood control but also to drive home to the domestic consumer the benefits of cheap electricity. With this end in view transmission facilities are provided to deliver bulk energy to the distribution systems of municipalities and cooperative associations. The prescribed rates for the retail sale of TVA power give the customer 100 kilowatt-hours at $3.50 and 500 kilowatt-hours at $7.90 on a monthly basis.

The TVA is serving as a proving ground for many interesting social and industrial developments. Many observers are viewing TVA as an excellent opportunity for much needed decentralization of certain industries, which will at the same time elevate the standards of living in many parts of the area now far below the national average. Advanced practices in engineering are being tested and applied. One such practice now under consideration is a scheme to use unmarketable surplus energy which comes at "off-peak" periods to pump water into storage reservoirs which will subsequently be released through generating units when the energy is marketable. The principle of hydro and steam plant interconnection underlies the total program of development of all dam sites along the Tennessee River and its tributaries. This principle, when applied to large areas, permits a maximum of energy generation with the minimum of cost and the most effective use of plant.

The second works relief appropriation made by Congress during the Roosevelt Administration expressly earmarked funds to be expended for rural electrification. This was a recognition of the fact that only about one farm in ten enjoyed the advantage of central-station electricity. To administer this program

President Roosevelt by executive order created the Rural Electrification Administration (REA). The policies since formulated by REA for its operation have been to make loans to public or private bodies for the construction of rural distribution lines. Borrowers of REA money are to repay the loan within twenty years with interest at three per cent. As we review the progress of REA during the first eight months of its existence we sense a growing tendency among utility companies to respond to the demands of the farmer for electric service. Looking ahead we see unmistakable signs of a fulfilment of the REA program through the combined efforts of utility companies and cooperative associations, which are rapidly growing in number and importance.

III. POWER, UNDER SOCIAL CONTROL, AS A COORDINATING FACTOR IN CONSERVING OUR NATURAL RESOURCES -

Pressure of population, national defense and conservation of natural resources have long been considered three outstanding problems of social policy. Economic disaster, physical catastrophes and social necessities are driving home to our people the vital need for conservation all along the line.

Conserving for man's use the maximum amount of power released by the flow of our waters is an important conservation measure. And, under wise social control, we must carry out a soundly conceived integrated program for the maximum use and control of water from the moment that it falls as rain on the headwaters of a great drainage basin until it finally reaches the sea. Planning for these goals must be on a high level with the most modern techniques employed. Control of surface waters for the conservation of land, of power, and of the water itself is man's immediate task if the virility of our national existence is to be preserved.

The need for conservation measures has been increasingly recognized for over forty years. Gifford Pinchot and Theodore Roosevelt did much to educate the American people to the destructive waste and wanton exploitation of our natural resources, especially as to our forests. Supplementing its power studies and power conservation measures, this Administration has made <u>comprehensive studies</u> of our natural resources and has energetically pressed conservation activities.

Late in 1934 the Mississippi Valley Committee reported on problems attending the use of water in the Mississippi Drainage Area. As a result of their studies the members of that committee unanimously concluded that the time has passed when isolated or unrelated plans were adequate to American needs and reported that:

"Planning for the use and control of water is planning for most of the basic functions of the life of the Nation. We cannot plan for water unless we also consider the relevant problems of the land. We cannot plan for water and land unless we plan for the whole people. . . . The need for planning arises out of the needs and desires of the people. . . . What must be sought is effective means for carrying out the common purpose, not only in the interest of the living generation, but for the protection and enhancement of the lives of all generations to come."

Thus the problems of an integrated power supply, rural electrification, promotion of navigation, erosion control, and flood and low water control in our greatest valley were found to be closely interwoven.

In a somewhat similar study, the Water Resources Committee of the National Resources Board surveyed the status of the water resources of the entire nation and in each of the great drainage areas it found similar problems. The conservative New York

Times recently made the following summary and appraisal of this Committee's conclusions:

". . . . A document of the highest social importance . . . Its Water Planning Committee developed the first comprehensive proposal for the control and utilization of the nation's streams - from rills to mighty rivers . . . The Committee's survey makes it plain enough that the problem presented cannot be solved by individual communities and States. It is regional. It concerns not merely the Mississippi and its tributaries, but the countless little streams that interlace the country from coast to coast. With it are bound up recurrent droughts, erosion that carries away the topsoil of the upland farms and leaves hardpan almost as impervious to water as a sheet of glass, waterpower plants, irrigation projects, pollution of streams, inland navigation, municipal water supply, water conservation and water utilization in their broadest aspects."

"If the floods have taught us anything, it is the need of something more than a dam here and a storage reservoir there. We must think of drainage areas embracing the whole country - think of small projects which number thousands, but which are necessary, individual pieces in a vast mosaic of definite pattern, think of major engineering undertakings in terms of decades."

Three Federal agencies - the Soil Conservation Service, the Resettlement Administration and the Rural Electrification Administration - early this year prepared a report entitled "Little Waters: A Study of Headwater Streams and Other Little Waters." In transmitting this to the Congress, the President said:

"This report treats of a subject with which the physical wellbeing of our people is intimately bound up, yet to which, in the past, too little attention has been paid. We have grown accustomed to dealing with great rivers, with their large problems of navigation, of power and of flood control, and we have been tempted to forget the little rivers from which they come. The report points out that we can have no effective national policy in these matters, nor in the closely related matter of proper land uses, until we trace this running water back to its ultimate sources and find means of controlling it and of using it."

"Our disastrous floods, our sometimes almost equally disastrous periods of low water, and our major problems of erosion, to which attention has been called by the reports of the National Resources Board, the Mississippi Valley Committee, the Soil Erosion Service, and other agencies, do not come full-grown into being. They originate in a small way in a multitude of farms, ranches and pastures."

"It is not suggested that we neglect our main streams and give our whole attention to these little waters but we must have, literally, a plan which will envisage the problem as it is presented in every farm, every pasture, every wood lot, every acre of the public domain."

". . . . Our objective must be so to manage the physical use of the land that we will not only maintain soil fertility but will hand on to the next generation a country with better productive power and a greater permanency of land use than the one we inherited from the previous generation. The opportunity is as vast as is the danger."

"Little Waters" illustrates in simple terms by means of photographs,

drawings and text, the need for controlling little waters, the enrichment of human life that would result, and the most modern methods of such control. Through check dams, reforestation, the development of small ponds and reservoirs, terracing, contour plowing, strip-cropping, and proper crop selection, the movement of water can be retarded, infiltration encouraged, and natural underground storage reservoirs replenished.

It is sometimes argued that under our Constitution the nation is powerless to protect itself from the curse of floods and the degeneration of our soils or to integrate its efforts for water control and conservation. Elihu Root, one of our great constitutional lawyers, in 1913 vigorously supported the position that the Federal Government has wide jurisdiction over drainage basins in their totality, when he said:

"A waterway is a whole. Navigation at a particular point does not stand by itself. The streams that we have been working upon for many years we improve step by step, mile by mile, beginning with a dam here, making a pool above it, and going on and building another and another and another. Each is as much a whole as any transcontinental line. The Supreme Court of the United States based its decision in the Rio Grande case. . . . upon that proposition, that although the portion of the Rio Grande, the treatment of which was called in question, was not navigable, nevertheless the Rio Grande must be treated as a whole, and the treatment of that non-navigable part must be considered with reference to its effect upon the navigation of the lower part of the stream. Therefore, Federal authority could deal with it.

"Upon no other ground do we justify ourselves in the purchase of Appalachian forest reserves except to preserve and give out gradually the water which flows down through the navigable streams of the Atlantic seaboard.

"From the mouth to the source and in all the contributory feeders a water system of navigation must be treated as a whole. . . ."

These waters in the end will be treated as a whole by the law just as they must be treated as a whole in our social and engineering planning. A few days ago I testified before a Senate committee in general support of a bill for a Mississippi Valley Authority. The essence of my testimony was that for effective results the great water control works in the lower reaches of our rivers must be supplemented with the proper conservation of water in the headwaters of these rivers.

The recent floods have given renewed impetus to the drive for comprehensive national planning as to soil, water and power. The dramatic force of the floods raging through twelve of our states, the loss of several hundred lives and property destruction totaling over 500 millions of dollars all serve to impress upon millions of our people the need for positive action of a character that will prevent these major catastrophes and control water so as to make of it a valued servant instead of a destructive enemy.

It is fortunate indeed that coupled with this growing public consciousness of the need for an integrated program we find ourselves with a wealth of man power and a solid foundation of national credit with which to start the job. Such a program would require the maximum social control of power supply as well as of waters. In earlier years undeveloped resources and expanding industry absorbed our labor and strained our credit. For some time to come, there may be a great pool of idle labor and a plethora of idle capital seeking employment. Productive employment for both is offered in saving man's irreplaceable land

and water resources and increasing the amount of electrical energy at his command.

Any program adopted will necessarily employ those methods of water control which will serve to make stream flow more uniform. Explorers have discovered many kinds of rivers but man has never found the ideal river -- the river with uniform flow throughout the year. Such a program implies a degree of headwater control and retardation of run-off that we have not had since the early settlers in this country destroyed the protection of forest and grass which nature provided to retain her rainfall for the benefit of all forms of life.

Agricultural objectives and methods must be revised on a nation-wide scale, soil "mining" must cease, and the destructive ratio heretofore prevailing of three acres of soil-depleting crops to one acre in soil-building crops must be reduced. Grasses and legumes will gradually supplant crops that offer no protection against erosion.

By holding the rain where it falls, time is provided for it to be absorbed into the soil and to find its way into underground storage reservoirs. Much can be done by bringing about the general adoption of contour plowing, terracing and strip cropping. The construction of a vast system of check dams, and the restoration of the multitude of small ponds and swamps that a land hungry people improvidently destroyed, will make another important contribution to proper headwater control.

There must be the replacement of some of our earlier forest cover by forestation of great stretches of poor and hilly lands and by helping the farmer to restore or increase the size of his woodlot.

Enough has been accomplished by isolated experiments to indicate the remarkable results that would be produced by a nation-wide effort along these lines. The Director of the Soil Conservation Service has testified that by employing such measures "the volume of run-off water can be reduced 20 to 25 per cent -- the margin in most cases between mere high water and destructive floods."

Thorndike Saville, a careful student of water problems, testified after these recent floods that "From 40 to 50 per cent of the general damage and a greater per cent of the concentrated damage from floods could be prevented as a part of a comprehensive watershed development."

The benefits of these measures in holding flood damage within reasonable limits and in checking the cancerous growth of soil erosion are beginning to be well understood.

Let us explore the effect of these measures on the national power picture. During the past ten years in the United States, electricity produced by water power has varied from 34 to 41 per cent of the total annual production. These variations have depended upon such factors as the volume and timing of precipitation, capacity of existing hydro-electric plants and the demand for power. In 1932 for example, the lack of industrial demand for power resulted in a sharp curtailment of total production and a normal water power production for that year amounted to 41% of the total - a new high.

Water control measures which increase the uniformity of stream flow will serve to add to the output of existing water power plants. These measures will provide for the development by future generation of water power which will be needed to meet increasing demands for electric energy. Increasing integration of al power producing sources will tend to decrease the cost of electric energy and thus open vast new markets for it The wider the integration, the more feasible it will be to use hydro generated energy to supplement fuel

generated energy rather than to compete with it.

Greatly increasing the upstream storage capacity, both on the surface and through utilization of natural underground storage reservoirs will have an important influence in regularizing the use of downstream reservoirs. Reduced to its simplest terms, the process is one of providing many small reservoirs upstream as the necessary corollaries of a smaller number of large reservoirs downstream.

Present private power practice, and recent developments in flood and soil erosion control clearly indicate that all dams in the future should be considered as multi-purpose dams. A constructive social point of view will require that they be so designed and located as to yield the maximum social benefit in terms of power production, navigation, flood and low water control, water storage, soil erosion control or any combination of these uses.

The idea is rapidly becoming obsolete that most great dams should be built for a single purpose, such as navigation or flood control - and effective upstream control will do much to remove any justification for it that may have previously existed.

A splendid illustration of this is found in Ohio. Following the historic Dayton flood of 1913, Dayton's advisers turned to England- where physical conditions do not make water power development possible - for guidance. As a result a Conservancy District Act was passed. "Conservancy" is an English term and relates largely to straightening rivers and preventing floods. Just as the word lacks the broad connotation of our word "Conservation", the scope of the Conservancy Act was narrow, power was excluded and you will find on each of these dams a tablet which reads:

"THE DAMS
OF THE MIAMI CONSERVANCY DISTRICT ARE
FOR FLOOD PREVENTION PURPOSES
THEIR USE FOR POWER DEVELOPMENT
OR FOR STORAGE
WOULD BE A MENACE TO THE CITIES BELOW"

Laws linger on long after the ideas which gave rise to them have been buried. Twenty-two million dollars of Federal funds in addition to over twelve million dollars of local money will be used to build a series of flood control dams for the Muskingum Conservancy District - but under this antiquated Ohio statute not a kilowatt will be developed.

There is a movement under way to replace this Conservancy District Act with a more enlightened statute which will provide for a more complete use and control of the impounded waters including the generation of electric energy.

In accordance with the traditional view that large dams should only serve a single purpose the Tygert River dam, which the Federal Government is building to regularize the flow of the Monongahela, for the benefit of heavy traffic in coal and iron products, necessarily would be precluded from being used for power purposes. Rainfall records of that drainage basin proved that there would be frequent periods when stored water could be used for power without endangering navigation and flood control, but it required strenuous efforts to have the design of this dam changed to provide the penstocks without which future power developments would be impossible.

The expenditures of our Federal Government on our waterways have been mounting rapidly. Over a billion dollars have been spent in the past ten years - a considerable portion of it for dams. Most of the dams constructed with these funds served the single purpose of improving navigation.

In the absence of social planning and social control, sufficient consideration was not given to the possibilities for the disposal of power which might be generated at dams to be constructed for such a purpose as navigation. Proposals for power development have usually been dismissed with the statement that there was no immediate market available or that the energy that would be generated would be secondary or dump energy and hence of little value. Conjectural rates used in estimating revenues were frequently unduly low.

The experience of our small interconnected systems and the lesson to be learned from them has largely been ignored.

Proper planning today definitely recognizes that such water power developments may be of great value in supplementing existing steam plants, and that the value of a kilowatt at peak periods is much greater than its average worth.

Secondary energy available for nine to eleven months in the year is valuable in an area where practically all energy is steam generated.

The nation is poorer because past practice has not included comprehensive studies of energy disposal covering its utilization in combination with existing steam plants.

Both the studies as to water control and the actual construction work begun at so many upstream points during the present Administration prove that these large multiple purpose dams on the lower reaches of the rivers will have their counterpart in small automatic water power plants that will spring up to utilize the many new small reservoirs that headwater control will require. The complete automatism of these new plants that recent designs provide make them economically efficient producers and they have the social advantage of utilizing an inexhaustible resource.

If we will but think of our great hydro works in terms of the dynamic organism of the drainage basin which lies behind them rather than merely as the inert wall which barricades the stream, we achieve a true picture of cause and effect. Within this structure we can scientifically diagnose ills and prescribe remedies to be applied at the source of trouble. Dams silted to the flash boards, thriving towns flooded to the house tops are but symptoms of a disease. The control of these catastrophic phenomena must be applied all the way down from the field and forest catch-basins. When the natural receptacles are destroyed by unwise cultivation and land-use water accumulates rapidly, moves even more swiftly, swells to great heights, then vanishes. But we may largely guard against this damage. We may convert the entire drainage basin into a storage reservoir, or millions of storage reservoirs, if you please, to be tapped throughout the year and utilized to advantage. Such a picture is more pleasant, more hopeful to contemplate than the angry surge of rampant flood waters tearing and cutting away the good earth. Whether we like it or not the Nation must gird itself for this herculean task, if our civilization is to survive.

The consolidated gains of a well managed drainage basin are tremendous. Through well conceived integration and coordination of the small individual actions within even a small basin we develop power, create new raw materials for power use, preserve the land without which power is of no avail. To preserve this heritage, to pass on to posterity its due, we must act speedily to perfect this new, this almost revolutionary form of control. It is not the control of corporate monopoly which seeks to mine our pocket books which is most urgently needed, but social control

to effect practices which will preserve the very land from which we spring.

Fortunately our nation appears to be in the mood for a great conservation program that will represent this generation's effort to conserve for our civilization essential natural resources. Power development is an integral part of this program. Cooperation by and with private interests will be mutually helpful. But the burden is too great for private enterprise. The leadership must fall to Government.

Just as new techniques of water, erosion, and power control are being developed to meet these demands, new techniques of social control are slowly being perfected. Our ability as a people to meet the challenge of the coming years is dependent upon the success of these efforts.

THE WORK OF THE NATIONAL RESOURCES COMMITTEE

By
Charles W. Eliot II
Executive Officer, National Resources Committee

I am going to try to tell you tonight something about the work in which the National Resources Committee is engaged and why we must plan for our resources. When Dr. M. L. Wilson inveigled me into making a talk in this course, he assigned me the subject of "Resources" but he said at the time he knew quite well that I would talk about some other subject and it didn't make any difference what the title was. So I have already taken one liberty, and will talk to you about "Planning for Our Resources" rather than just "Our Resources".

Presumably, not many of you are familiar with this planning job which has been under way on an organized basis here in Washington since the new Administration came in. It started in the Public Works Administration through a National Planning Board which was set up by Secretary Ickes right after his appointment as Administrator of Public Works. He appointed three men, Frederic A. Delano of Washington, Engineer, Economist, Banker, a former railroad president; Charles E. Merriam of Chicago, Political Scientist, Professor of Political Science, at the University of Chicago; and Wesley C. Mitchell of Columbia, an Economist probably well known to all of you through his writings on the business cycle. These three constituted a planning board, and they had that resounding title, "National Planning Board", bestowed upon them by Secretary Ickes, with the blessing of the President.

The significant thing about that action and that occurrence in July, 1933, was that it was not, as it might sound, a beginning of planning for our resources, but rather a continuation. It is very bewildering these days to hear all this talk about economic planning and excitement in the political world about planning in general, when you remembee that it was President Hoover who set up the Committee on Economic Changes and later the Committee on Recent Social Trends, which were just the same kind of planning effort which we are now carrying on. So it was all the more strange that a few months ago, in November, 1935, on one evening former President Hoover made a vigorous address in New York in which he blasted economic planning from this end of the world to the other, and the morning after President Roosevelt came out with a statement that we need "more and better Local, State and National Planning".

You might think that that was a direct conflict if you didn't remember that two of the three men who have been in the forefront in this planning work since the present Administration came into office were respectively the chairman and vice-chairman of those two committees which President Hoover himself had set up, so that there has been real continuity. It is a non-partisan, non-political movement.

Perhaps you might be curious—I hope you are—as to why I am involved in it. You may be able to understand how people who had been picked out by President Hoover were carried on, but where did this man Eliot show up? Perhaps the approach to planning represented by my training would be useful for an under standing of the problem and it is

therefore not in a boastful spirit that I am going to tell you a little about myself.

I started out as a landscape architect, which involves the agricultural, horticultural and the engineering approach. The first job we had in school was a planning job. We were given a house lot to lay out, to put the service arrangements in the right place, to put the house in the proper orientation for sunlight in the living room, and to get the most out of a small piece of ground - to make the most of the resources that that house lot had to offer. We went from studies of that to the next subject, which was the grouping of several house lots; then to cutting up a site into a new community, usually called a sub-division. We went from that to still another subject, trying to relate that particular sub-division to the facilities for the whole community, the local store center, local playground, and school facilities, and so we gradually built up the neighborhood idea of having our part of the neighborhood interests in proper relation to the other parts, and on to what has become known as town and city planning.

All this is a perfectly familiar approach, and I hope it does not stir in your minds any bugaboos of "economic planning". Certainly anybody connected with the agricultural world knows with precision, that one part of the farm should go into one crop and that another part should go into other crops, It is a perfectly natural process of trying to fit the resources and possibilities of a site to the needs.

My next personal experience, if I may continue to be personal in these remarks, was as a city planner for this city of Washington, I was there for seven years and got some understanding, I hope, of how the problems of a large city inter-relate with those of the Federal Government, and how they bear upon these problems of organization for the best use of our physical resources. From that it was my privilege to get into this national planning field. But the rest of the world has by no means jumped all the way from city and metropolitan planning into national planning.

One of the first activities of the National Planning Board which was set up in 1933, was to try to get the States to do something for themselves. The members of the Board felt strongly then - they do now - that it was wise, in fact essential, to the continuance of the planning work to have the people of the individual States say to themselves,"These are our resources, our facilities; what are we going to do with them for the benefit of future generations". So as a means of stimulating them and encouraging them to do something, we secured an agreement with Mr. Hopkins at the time the Civil Works program was just being launched, and with Secretary Ickes, for help from the Public Works Administration. We made an offer to the Governors of the various States that if they would set up a planning agency for the State, we would try to help with some funds for a staff and for consulting advice. Prior to that time, only three or four States had anything which by the longest stretch of the imagination might be called State planning. A few States had set up conservation organizations which had engaged in some kind of over-all thinking as to the resources of the State, but practically nothing had been done except in New York and Wisconsin, a little in Iowa, and a little in Illinois. The New York story, I suppose, is primarily responsible for the interest and enthusiasm of President Roosevelt, for there, largely through the efforts of Chancellor Mann of Ithaca and the work done by Mr. Clarence Stein and others, a real start had been made on the sub-marginal land program and

the conversion of the higher land areas, where the growing season is short and the soil is worn out, into forests. In the Western States, particularly in Wisconsin, planning interest had grown with the zoning movement and with the effort to make the highway program fit with the prevention of further settlement in cutover regions of the Lake States.

To our great surprise, this suggestion that planning by the State might be worth while was grabbed hold of with great enthusiasm by Republicans and Democrats and Farm Laborites and by everybody in sight, so that within a year, 46 States had set up official State Planning Boards, and within another year, 32 of the States had passed legislation to put that work on a continuing basis. And so this idea of some central planning organization assisting the Governor of the State and the various bureaus of the State Government in an organized attack on the waste of their resources, has really gotten under way.

But that was not by any means the only result of this State planning effort--this effort on the part of the National Planning Board to decentralize and to get people locally thinking about their own problems. Last spring, at a conference in Cincinnati, a further movement was launched to get the State Planning Boards to encourage and stimulate local planning in towns, cities and counties in the same manner in which the Federal Government was trying to stimulate the States. That effort, also, has been rewarding in a very extraordinary degree. There are some 800 local city and town planning boards now functioning in this country, practically all of them on a voluntary basis. The members serve without pay, in very much tee same manner in which school boards and park boards serve all over the country. As to agricultural planning in the counties, the work which Dr. Black and Dr. Wilson have fostered, the county planning movement has spread to some 400 counties by this date and is still growing. These county planning agencies are often outgrowths of planning interest in the county town, what you might call the more urban part of the county development, and they have had their most successful growth in places where the urban problems have come to the front; but that does not mean that they can not be useful in the completely rural sections.

Still another development has already begun to show itself in the grouping of counties for what might be called district planning boards of intercounty planning agencies. The whole of the State of Idaho, for instance, is now organized with district boards with members from four to five counties on each board, and the same kind of organization is going forward both in Montana and South Dakota. The only State where this kind of intercounty organization has been set up officially by State action is in Tennessee, where, with the help of the T.V.A., great progress is being made in two regions, one at the Eastern end of the State and one at the Western and of the State of Tennessee. The Eastern example has perhaps had the biggest success, where they have five counties working togetherein a single district planning organization.

Those of you who are familiar with the Governmental problem involved in such a set-up all over the country will see in this district planning movement a very significant possibility for reorganization of our county governments, consolidation of counties and a very greatly increased efficiency in our rural government

processes. It is a mere beginning, perhaps, but at least it indicates the possibility of several counties working together on non-political problems.

I have given you a sort of running account of the idea of planning from the smallest house lot up to the State. But you must realize, of course, that it does not stop there. We have most of our biggest problems in the interstate field. Last fall the National Resources Committee got out a report on the progress of "State Planning", and it was followed within a month or so by another report on the "Regional Factors in National Planning" which dealt with these interstate problems and methods of interstate organization.

This interstate problem appears in all of our work with water resources, because water running down hill pays no attention to State boundaries. It appears in land problems, because soils are no respecters of boundaries, at least of political boundaries, etc., and through all our natural resources and most of our human resources, there is no such thing as a political boundry outlining the extent or the intricacy of the problem which must be faced. We tried to bring together in this book which we published last December some of the outstanding problems which were of an interstate character, and the ways which have been invented for dealing with those problems.

Of course, the T.V.A. is the obvious demonstration unit, the one which has received the most of the publicity and attention. The Federal corporation with State participation is one way of doing it, to get rid of all questions of State lines at one fell swoop.

On the other hand, down in the southwest corner of the country, we have another method which has been tried out apparently with some success, after great efforts by President Hoover in the negotiation of the Colorado Interstate Compact, with the result that Boulder Dam is now complete. There's a case where States first had to be brought into an agreement as to what should be done, and then the Federal Government put up the money for the construction.

In the Pacific Northwest, still another method was tried, and the Bonneville Dam is fast approaching completion, and Grand Coulee is under construction. There, without any State action, the Federal Bureaus have gone in and simply built the great structures for the better use of the water resources of the Columbia basin.

Up in New England, there is still another kind of set-up dating back some 15 years. The New England Council has been working along with the support of the New England Governors and with the financial support of the Chambers of Commerce of New England for these 10 or 15 years, and in 1934, a New England Regional Planning Commission was organized out of the New England Council background and with the support of the State Planning Boards, the Governors, and the National Resources Committee. That agency rests entirely upon the consent of the States and can only exist with their full cooperation and support. So there you have a whole series of types of organization for meeting or attacking these regional problems. More recently still, two other of these regional organizations have come into being--one an organization of the States along the Ohio Valley through the Ohio Valley Regional Planning Commission, which has its seat in Cincinnati, and the other, within the last two weeks, a committee on interstate cooperation between the States of New York, New Jersey, Pennsylvania and Delaware, which is going

to try to do something about the problems along the Delaware River. The river system is a convenient unit for attack on these problems because so many critical issues arise in the way in which we use and abuse our water resources. In the case of the Ohio, for example, we have a stream which was developed very completely and at very great expenditure by the Federal Government for navigation purposes and where the pollution problem has hardly been faced at all.

In fact there are some 10 related problems on all streams, and no one of them can be finally solved without attention to the others. The situation on the Ohio River that has now caused the creation of a new organization is due to the fact that they did not have this general, over-all, comprehensive planning for the future when they started the improvement, as they called it, of the river. We went out last fall to a meeting in Cincinnati at the call of the Cincinnati Chamber of Commerce, and they wanted something done about the sewage problem right away. I suspect they wanted Federal money, but they did not come right out and say so.

They wanted the cooperation of the Resources Committee in getting something started. They announced quite plainly that they were tired of drinking their own sewage and they had good reasons for being tired. The health conditions there are serious, but there is no use in Cincinnati doing anything alone because the cities above Cincinnati and below Cincinnati were equally at fault in simply dumping their sewage into the stream. This kind of problem cannot be solved by any one city or State, nor can it be solved by the United states alone. There must be some kind of cooperation. That is the gap that we are trying to fill through the organization and planning of the job.

Now in the national planning field. We have gone at this idea of planning for our resources in a somewhat different way than most people interpret the word "planning". As I told you a few minutes ago, we are quite convinced that it is a non-political activity and that continuity is essential to its success. Planning which is not continuous will immediately get out of date, and there is nothing which could possibly be so dead in all this world as a dead plan. It would be a straight-jacket if it is not changed. It would do very much more harm than good unless it is constantly revised and brought into accord with new inventions, new scientific discoveries, new ways of living, which we expect to see and hope for.

Another aspect of it that I think has to be emphasized these days is that planning is not concerned primarily with the execution of plans. The kind of planning which the National Planning Board, the National Resources Board and the National Resources Committee have in mind, is advisory and separate from the execution of the job. The minute you get into the execution side of it, you will be apt to leave your planning behind and become absorbed in the details of execution. We have tried in all of the work of the National Resources Committee to be a coordinating agency, a research and stimulating organization rather than an executive or administrative agency.

We are trying to set up a general staff for the President and Congress in the same spirit and manner in which the general staff of the Army serves the War Department - a steering committee, if you like, but more accurately a research organization. Now this function of trying to find the strategic points as Dr. Merriam, a member of the committee always puts it, and of

locating the emerging problems is very close in its analogy to the war problem. The general staff of the War Department are always looking for the possible emerging problem in wartime. So specifically should a peace staff be looking for the emerging problems in our economic, social, conservation, and other problems that we are sure to face as the years roll along.

We should not try to control or put the whole organization of society into a straight-jacket, but we should try to seek out strategic points, the places in the flow of policy where a minimum of pressure, a minimum of public opinion exerted at that moment may change the whole course of events. In other words, we are seeking the key points, and not control. I have, personally, an anathema against this constant talk about control. The thing we want to do is to influence and not control. You never can control anything as great as the people of the United States - you may be able to influence them a little bit if you have the facts and are not over ambitious.

What have we done in this national planning field? We have gotten out a lot of books. We are engaged in the preparation of a lot more. I don't suppose many of you have read those books. You may have seen them --they are quite large tomes. Our first one was on national planning itself. It was entitled "The Report of the National Planning Board", and it set forth the principles on which national planning might be set up and organized in the manner in which I have just mentioned.

When that report was submitted the President asked the same group with the addition of five Cabinet officers and Mr. Hopkins to undertake a special report on land and water resources. For that work, as you may know, we secured the help of a Land Planning Committee and a Water Committee which had formerly served as the Mississippi Valley Committee under Morris L. Cooke.

In addition to the land and water reports, however, we had some previous work which was almost complete on the organization of public works, on certain scientific data questions, such as mapping, stream gauging, soil surveys, and other necessary data which would be brought together and made available to those who are trying to make the plans. That large report which came out in December, 1934, was issued by the National Resources Board.

We have had a varied career. We started as a National Planning Board and then became the National Resources Board. Last year we were renamed again the National Resources Committee. We were faced with a necessity for re-organization because our previous authority depended on the NRA Act. We shifted to the Work Relief Act as our legal source of action. It is a little bit confusing for the general public to have this change of name every year, but the work goes on just the same.

The next report was the State Report that I have spoken of. We tried to bring together what the States were doing. Then came the Regional Report which was issued last January. Now we have a series of additional documents on the way.

Last year we succeeded in persuading a group of scientists to get together for discussion of planning problems. It was a very unusual accomplishment when three members of the National Academy of Sciences and three members of the Social Science Research Council and three members of the American Council of Education were persuaded to sit around the same table. They met last spring, and they have had several meetings since. It is a very stimulating group. They are interested in other kinds of resources. They have gotten two

studies under way which will be out in less than a year and before the public - one on our population problems, and one on technology and the impact of new inventions on social organization.

Those two studies, as those of you who have seen the reports on Recent Social Trends will realize, carries on very definitely some ideas and some programs which are outlined in those two volumes. The first of these studies is under a committee headed by Dr. E. B. Wilson of Harvard, and the second by Dr. Wm. F. Ogburn of the University of Chicago.

Another study that we are going ahead with is in the field of public works - an effort to bring together programs for use in building the next year's budget. That is in a sense a continuation of the function previously performed by the Federal Employment Stabilization Board and of the policies established for the cooperation with the state boards. It is an effort to build a combined Federal, state, and local program.

Then we are going on with the land and water work. We have just started in the field of land p planning another research operation on the problem of land tenancy. Another activity on the land field grew out of our land report of last year, that is, the record of proposed land purchases. It sounds almost silly, but up to that time, as some of you here in the Department of Agriculture probably know, there was competition among various Federal bureaus to buy the same piece of land, and efforts to obtain operations on the same piece of land were under way in the field. Through an Executive Order, the National Resources Committee is a reporting office which all Federal bureaus inform of all proposed purchases so that any duplication of effort can be spotted and the agency informed.

Also, in the land field we have gotten started on something which may develop into an interesting program of coordination on policies of land management in relation to wilderness areas and recreational areas. We have found rather a confusing situation among the agencies which operate large areas for those purposes. The Forest Service has a terminology for wilderness and recreational areas, where the same words may mean entirely different kinds of management from what they mean in the National Parks Service or in the Biological Survey. We are trying to get a uniform terminology on what kind of area they are all talking about. That in turn may affect the policies adopted by the different bureaus and help to bring some kind of agreement on how to handle these large tracts which are used for recreation or for preservation of the primitive or for wild game or whatever it is.

That same problem was attacked from another angle last summer by the National Resources Committee in an effort to find out what was possible to be done in the way of exchange of expert personnel within the Government. As all of you probably know, there is a constant problem of preventing bureaus from duplicating the expert services in another bureau simply because of bureaucratic tendencies or a desire to be self-sufficient. That general tendency has been aggravated by the policies and legal requirements of the Budget and of the appropriation Acts, so that a great many difficulties are put in the way of one bureau using an expert from another bureau. We are trying to find all the ways of getting over those quite proper restrictions and yet conforming with the necessary requirements of Budget procedure.

In the water field similarly we have a series of new enterprises under way. One, which has had some publicity of late in the papers because of the President's interest in it, is a study of twenty national drainage basins, with a view to picturing in words and maps the ultimate development of the total water resources of that basin.

There are a great many of these problems and uses of water which do not always run together. We have flood, irrigation, and drainage problems, pollution, navigation, reforestation, and so on. I have only just touched on the list. And works which are started or created for one purpose may run afoul of another. So this project which is now under way is intended to show the relation of these ten or twelve major uses and problems of water in each of the twenty basins, and to provide as well as we may, a priority program or listing of projects in the order in which they might logically be undertaken to carry out the plan. Perhaps, the first step is to purchase forests; perhaps, on the other hand, it is to put in a sewage treatment plan down below. Whatever the order of efforts is, we hope to bring that out in this report which is due for transmittal to the President next December.

Also in the water field, the committee is engaged on various kinds of flood studies prompted by the recent floods, and on problems of hudraulic data. We know altogether too little about our streams and how they act, and why we have this sudden run-off of water at certain times. As those of us who are connected with scientific bureaus of the Government have been constantly aware, there seems to be very little prospect of our getting full information. Something has to be done about that; some indication given by qualified engineers and scientists as to how we can get adequate information.

That committee has gotten a few individual projects under way which also have their amusing and interesting sides. One that came to us from the Reclamation Service called our attention to the situation on the Rio Grande River where the Federal Government was deliberately competing with itself for water which did not exist on irrigation projects which were being financed through the Reconstruction Finance Corporation or new projects being constructed through subsistence homesteads or some other agency. We have dealt with an inter-state commission which had been set up five years before to settle all these problems. They found themselves unable to agree, because the States concerned could not find a common set of facts from which to work.

It was necessary for some outside agency to be the go-between or the medium for acquiring those facts. We are able to help them. We get agreement to have a year's project put under way, to find out exactly how the water is being used. I took my hat in hand, and with Dr. Barrows of Chicago we went from one Government agency to another and collected five thousand dollars here and ten thousand dollars there from various bureaus out of their regular appropriations to do different parts of the job. We got money from the different states and two hundred thousand dollars from the Public Works Administration, and with that a project is now under way in the Upper Rio Grande, to ascertain just how much water they really have and how they use it.

That kind of thing gives you a concrete example of what planning is. Still another case of planning and coordination came up through the Secretary of Agriculture. The Biological survey, as you may know, has been very much concerned about the drainage of various areas where wildfowl formerly went for their

breeding or feeding grounds. They were in direct conflict with the policies of the Public Health Service, and policies of the Agricultural Engineering Bureau, with the Works Progress Administration, and with various other agencies. As a result of the report which our water committee got out showing those conflicts and the necessity of something being done about it, the President issued another order whereby the water committee is serving like the land committee as a clearing house for these projects. Projects must be reported to this clearing house.

That kind of service looks small and very obvious, but is something which we have never had in this Government as far as I can make out until very recent years. It is a kind of service which will have very large significance in the cooperation and use of our resources.

The Resources Committee is, as I have said, now composed partly of Cabinet members and partly of citizens. All of our coordinating committees are similarly set up with people inside the Government and people outside. We hope we get some of the citizen's point of view as well as the bureaucratic point of view. We try to see the problems as they are presented from both angles, but that carries with it many complications. The mere fact that the Board is so composed had made it all the more evident and essential that the planning agency should keep out of administrative work. Therefore, our organization is very small; it always will be small, we hope. There is an initiating and coordinating job to be carried on, and not an administrative job. I think I have given you some idea of the character of the set-up. If you look in any of our reports, you will find that the recommendations are purely advisory. We believe that it is fundamental to the success of all planning that it should always be strictly advisory, and should rest upon the consent of the appropriate powers, either the body politic, or the Members of Congress, or the President, as to whether or not these policies and programs should be carried on.

Something positive has to be done, or we are going to find ourselves caught in the very embarrassing situation of using up our resources, emphasizing one thing at the expense of another, not seeing the picture as a whole.

Somebody should be in a position to see the problem as a whole and to advise the Departments, the President, and the Congress, as to where these emerging problems are coming to light, and where the possible places of attack on them are, and showing where something useful can be done.

(Discussion continued on next page.)

DISCUSSION

Question-

What is the most effective way of organizing a stream system to avoid the sort of floods we had in recent months? We have in the Miami Valley a certain approach to the problem. I remember having crossed one of those big dams on the drive from Columbus to Indianapolis. I was rather impressed by the size of the thing and yet rather thought it was clear that they could not use a set-up of that sort for electrical power. Would you mind explaining that puzzle?

Answer-

The answer is that nobody knows. Some think the procedure should be to hold the water back in the hills through reforestation or through small dams, as was brought out in "Little Waters". - that emphasizes the project; of the Soil Conservation Service. Then there is the other type of project, the one of long standing in this country, so far as public acceptance is concerned - that of levees and dams on a large scale. There is a more recent scheme of the fuse plug, such as is now being worked out in the Mississippi Bottoms of high dikes, but with a chance to flow over in extreme high water and with a special area set aside where the water can spread out. That shows the two extremes of the procedures which we have been following, and in between there are endless varieties of combinations and possibilities.

In Europe, they have gotten somewhat further, perhaps, and are more accustomed to the problem, but at the same time they have much more control over the way in which people live and in the way they handle the other factors in the picture.

For instance, in the Rhine Valley. I am told they have provided a double system of dikes. One confines a regular channel, but a flood plain outside of these dikes is also provided where no permanent structures are allowed, where no houses are allowed, where a man can go in and take his chances as to planting but is not allowed to live there. That kind of control is something we haven't got.

I can just see the howl that would arise in my own State of Massachusetts if anybody should say you must keep out of the whole flood plain and not build any houses there. They would be quite frank in objecting to any Federal agency which tried to regiment them to that extent. The same kind of reaction has been met along the Mississippi, where the land is altogether too rich to allow it to go to waste and not be used for some return. That seems to be the difficulty in this country. We are still to much of the pioneering spirit to be willing to limit ourselves in the use of these resources.

As to your question concerning the use of the water. You should read the newspaper arguments between Mr. Arthur Morgan of the T.V.A. and Mr. Morris L. Cooke in relation to the Miami Conservancy dams, and more recently in the Muskingum Valley, where a similar system of dams is being installed. Mr. Cooke disagreed with Mr. Morgan, who designed the Miami system and had installed one of those big dams up above Dayton. Mr. Morgan declared that it was dedicated to one purpose, Flood Control, and should never be used

for power, and the reason that that was done was that for power you want your reservoir full all the time so as to get the greatest head in the water. For flood control you want the reservoir empty in the period before the flood, and Mr. Morgan felt that the temptation to make a little money out of the power would outweigh the precautionary sense of most people and that they would be tempted to keep the reservoir full to get a little more power.

On all our streams we face problems in the use of water, because some of these uses are absolutely at cross-purposes; others may be combined to some degree. We have to know just which is the dominant job, and which is the thing that must be subordinated.

Question-

I wonder what chance you think we will have toward the coordination of the two ideas we have of flood control, the two ideas that we have had for years, the two main ideas in the minds of our people with so little water, and the idea of the Army. What is there between those that we could have?

Answer-

We want both.

Question-

Separately, or together?

Answer-

I don't think they are in any way inconsistent and we can have both if we plan for it. It is a question at the moment as to which you emphasize. They are not inconsistent because the holding back of the water makes it valuable in the dry season for use down-stream, and as the large dams are usually built down-stream, they can be used for either power or flood control according to how effective the up-stream holding job has been.

Question-

Does the Committee act in an advisory capacity or as a coordinating agency in an international boundary problem? For example - in the various projects that are now under way along the Rio Grande, there is a dam being built along the Rio Grande and recently there was a proposal to make a survey of that part of the river below Brownsville to the Gulf. It occurred to me during your talk that no doubt the Irrigation or Reclamation Service have projects along there too. Does the National Resources Board act as a coordinating agency?

Answer-

The organization is still only two years old, you must remember, and we have tried to "hide our light under a bushel" to the best of our ability. You probably have noticed that there has been practically no publicity about what the Resources Committee has done. We believe this kind of job must be

backed up by a lot of information, facts. Also, we believe it is the kind of thing that should not grow too fast. The international stream problems have a full panoply of commissioners and agencies already at work on them.

Question-

I was just wondering if it is not inconsistent that ultimately the National Resources Committee would be placed in a control position.

Answer-

I hope not.

Question-

In so far as planning or period of planning for these projects is concerned?

Answer-

No member of the Committee to whom I have ever talked has any desire to have the Committee exercise any powers other than advisory.

Question-

To run things only when they are requested?

Answer-

They want the chance to initiate suggestions, to make suggestions to the President, but in all cases to be strictly advisory. We will have another report out shortly on Bonneville Power. The dam will be complete inside of 18 months according to the Army engineers. Last spring the President requested us to get together some material on the organization of the region for distribution of that power. We have a regional planning commission out there who set to work and they are now making their report. The report has been reviewed and worked over and it is now ready for action on the suggestions it contains as to how that power might be marketed. There is a case where the President asked for an opinion, the same way that he asked for the land report the year before. In other cases like the study of "Technology and New Inventions", the Committee thought the problem was important. The initiative came in that case entirely from the Committee. It ought to work both ways.

Question-

I have a question relative to the administration of the Committee. Now is this National Resources Committee merely a national intelligence unit and do you appeal to the best brains in the country? Is that right?

Answer-

We try to. It sounds as though you thought the Board was a sort of brain trust. I call your attention

again to the fact that it includes administrators as well as other members. I don't think that any of them would agree that they were a "brain trust".

Question-

What I mean is relative to the scientific question. There may be some scientists that worked on the problem and that know more about it than the others might know. Are you trying to get their recommendations as to how to handle the required work?

Answer-

In each case where we have a problem brought to our attention we set up a special research committee and these committees are always composed partly of people outside and partly inside the Government. We realize that any policy which may be formulated will probably be referred to some regular Government organization, and unless they know what it is about, unless they believe in it, it won't do any good to formulate the policy. It is often difficult to get the "Bureaucrat" really excited and enthusiastic. This chance of bringing him in on the ground floor in the policy making has shown its value already as a very great stimulant and a very helpful activity in the way of broadening his point of view and his contacts.

Question-

It is really a problem as to the transgression of the principle according to the scientist and according to the politician. Is that it?

Answer-

I don't think it is so much the politician as it is the administrator. But that is always true in any combination of people that work together.

Question-

Where can we get some of the books you mentioned?

Answer-

They are all at the Government Printing Office and some can be obtained at our office.

Question-

You touched briefly on the human resources. Can you explain that a little further? And in Connection with land tenancy, semi-urban and urban?

Answer-

There are two attacks on the problem. One is a special committee which we set up for study of urban problems, on which Dr. M. L. Wilson is one of the members. They are

going to try to get some more data on that problem and some light on the trends as to whether we are going to go back to the farm or continue to flock to the cities. That problem is before that special committee. The other attack is through what we call the population committee, which is going at it more from the point of view of the total movements of population, fertility, and age groups, and trying to get something on the balance between the producing part of the population and the people who are dependent.

The kind of approach I am trying to get them to use is the kind that we have had experience with in the land and water studies, concentrating on prevention of exploitation and in wise conservation of our human resources. That means prevention of the wastes from sickness, from lack of education, from unemployment, and discussion of those problems, trying to focus public attention on those wastes. There is the kind of shocking statement that you get out of the social scientists that one child of every twenty now in high school will be in an institution caring for mental diseases before they die. That kind of thing very few people care to think about, and even fewer know about. It is something which we ought to think about.

Question-

I had more in mind from the standpoint of output, and had particularly in mind the Rural Electrification Board which would tend to decentralize industry to a large extent. Would your organization help to coordinate?

Answer-

We would be delighted to help if we can. Our method in each case has been to set up those committees, and then to go to the regular bureaus to try to get them to participate. In the case of the big land report, Dr. L. C. Gray was in charge, and the different bureaus made most of that report with a little additional financial help and a little additional personnel supplied by the Resources Board. But then again we don't want to set up an administrative machine. We want to work through the other agencies and act as a catalyzer, if you like, and to bring union.

Question-

I should like to know if your agency has any connection with the suburban projects of the Resettlement Administration?

Answer-

You mean "Green Belt" and the rest of them? We have only been consulted, but they have run away with a good many of our best men. Other than that we have not had any connection.

Question-

I should like to ask whether the National Resources Committee is interested in erosion control.

Answer-

The Committee was among the first to point out the relationship of erosion control, farm credit, crop restriction and related subjects. I think our function there is to show the interrelation, to show the possibilities. A very large part of the report on land in 1934 deals with erosion.

Question-

To go back to the state lines. What are the essential differences between the Wisconsin zone plans and some of the other plans, say in the case of New York City?

Answer-

New York has not done much in the way of zoning. The zoning scheme rests on the police power of the states. By common consent the citizens agree that an area is not suited to other than the following uses; this other area is suited to the following uses. That is declared by common consent, and that is the law. That is what zoning is.

Here in Washington, if you have a lot in an "A restricted" area, you can't build anything but a single family house. That is not by virtue of the public having paid anything for it but by the police power. In New York they have bought land outright and paid for it.

Question-

Is there any zoning going on in Florida?

Answer-

I don't know. There was a great deal in the suburban areas during the real estate boom. Whether it is on a rural basis I don't know. The only states that I know of where rural zoning has made progress is Wisconsin, Minnesota, and California.

Question-

There is good field for it in Florida.

Answer-

Another way of attacking this sub-marginal land problem is by something in between zoning and purchase. It has been tried in Massachusetts for the last forty years, in relation to the Boston Metropolitan Park System. There they bought a limited right in land. A right against building anything which looked like a billboard across the Charles River from a parkway. They only bought that one right, for one possible use of the property. That was all that was acquired by the public. In the same way, you could buy just one use, almost anything, and probably could get it for next to nothing.

Is there anything else I can try to tell you other than my own pet ideas?

Question-

Have you made any studies of the conservation of gas?

Answer-

There has been a study through thė Mineral Policy Committee, which was one of those reporting in this December, 1934, study, and more recently in connection with a study of reserves which is not yet out, which is in preparation - Mineral Reserves.

We are now trying to get a study going on competing fuels, which will bring in the question of natural gas and its mis-use and its possible uses. The astounding figures which Representative Mauri Maverick quoted a week ago in his radio address about some one well in east Texas where there was as much gas being blown into the air in twenty-four hours as would supply all of the domestic needs in the United States for one year was quoted from our December report.

PROBLEM OF LABOR
An Aspect of the National Labor Relations Board

By
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National Labor Relations Board

The National Labor Relations Act under which the National Labor Relations Board functions is based upon the idea that the Government ought to intervene with reference to labor relations. There has been a great deal of talk in the press as well as in other publications and through other means of expression about the fact that the intervention of the Government in labor relations is something new, something that has occurred only since the New Deal. As a matter of fact, those of you who are acquainted with the history of labor know that there has been Government intervention in labor relations running back certainly to the time that the United States became an important industrial country.

There are various forms of Government intervention in labor relations. I want to mention only a few. The President of the United States, for instance, has found it necessary on a variety of occasions to interfere in labor disputes. As early as 1877, State and United States troops were used to maintain order in a big general strike of railroad workers.

The Courts too have intervened in labor relations, particularly, since 1882, by the issuance of injunctions. And Congress has taken a hand, by way of legislation, certainly as far back as 1888, when specific laws were enacted with reference to the railroads. There have also been a flood of investigations. Congressional investigations of labor matters run back to 1886, when the Senate Committee on Labor and Education made a fairly exhaustive study of all phases of labor relations. Since that time Congress has set up various boards. There was the 1892 Industrial Commission which in addition to investigating other phases of the industrial system also made a fairly comprehensive and thorough study of the labor angle. In 1914 another commission was set up, called the "United States Commission on Industrial Relations".

The Labor Relations Board, however, is a rather unique set-up, there having been very few bodies of that kind in this country. It is also unique in the sense that perhaps no other country has attempted to intervene in labor relations in this particular form.

The function of the Labor Relations Board is to protect the right of the workers to organize for collective bargaining. There you have, you see, a very limited function. In other countries, when Governments have directly intervened in labor relations by setting up machinery, they have attempted primarily to regulate wages, hours and other working conditions. An example of this is the Canadian Trade Disputes Act, which sets up agencies with jurisdiction over certain important industries. When a controversy occurs over wages, hours or working conditions, a board is created which investigates and makes recommendations. Those recommendations need not be accepted either by the employers or by the workers, but the agency, you see, is directly concerned with the conditions of employment.

The National Labor Relations Board, on the other hand, has no power to intervene in controversies where issues of wages, hours, or other working conditions are concerned. The

National Labor Relations Board can only step in when there are charges made that the employer is interfering with the right of the workers to organize into labor organizations, or where the workers complain that the employer will not deal with them on a collective bargaining basis.

Now other statutes like the Canadian Trade Disputes Act, the legislation of Australia, or the special legislation of Great Britain and France, are mostly of the regulatory type, in that they actually attempt to set standards rather than merely to protect the workers in the exercise of certain rights. Incidentally, of course, this regulatory type of legislation also does make it easier for the workers to organize into unions and to bargain collectively with the employers, because regulatory bodies have to recognize certain spokesmen for the workers and those spokesmen are naturally the unions. Indirectly, therefore, the regulatory bodies of other countries are aiding and protecting the workers in their right to organize as well as in their right to bargain collectively. But there are no agencies that are particularly entrusted with that special protective responsibility except in the United States.

This is largely traceable to certain peculiar conditions in the United States which grew with the development of our industrial system. I want just briefly to enumerate some of those conditions in order to give you that special background.

Up to 1900 or even a little later, if we were going to survey the industrial system with reference to labor organizations, we would find that, on the whole, the workers were pretty well organized in most of the industries. There were very few industries in which there was not a fairly strong organization of workers which dealt with the employers and with which the employers were willing to enter into trade agreements. Beginning with what is known as the "trustification" period in the United States, when great mergers began to take shape and when we began getting what has now become known as the integrated firms, those employers began to introduce what has since become known as the 'Open Shop' policy. It was also known as the 'American plan' policy, but what it really was, of course, was an anti-union policy, disguised in this other type of terminology.

In other words, employers thought themselves sufficiently powerful to refuse to deal with the organizations to which their workers belonged. So they began to break up these organizations. In the steel industry, for instance, we find this policy appearing as early as 1892, in the famous Homestead strike of the Carnegie Steel Company, in which the company introduced Pinkertons. The company resorted to a variety of other union-breaking practices which have since come into fairly general use. So we find that by about 1910, the unions had been eliminated from most of the important industries, like steel, meat packing, electric manufacturing, and a great many other industries which now have become such mass production industries.

The employers, in other words, were powerful enough to break up the unions, and they were powerful enough to keep out the unions in newer industries like the automobile industry, and in companies where the unions had never really succeeded in getting themselves established. As a result, we have a unique situation insofar as the United States is concerned. The important industries became non-union. The workers in those industries had to submit to what the employers called individual bargaining. The employers would not accept any form of collective bargaining. At a more recent period when the idea of collective bargaining became powerful, the employers, of course, changed their attitude. They now say that they believe in

collective bargaining but only with company unions.

During the War, the Government had to intervene in order to expedite production as it had to see that the armies were supplied with foodstuffs, ammunition, clothing, etc. The Government had to take a hand, and a firm one, in regulating labor conditions.

Of course, when the Government intervened in labor matters, it also began to protect the interests of the workers in their right to organize and in their right to bargain collectively. By that time the workers were able to reëstablish unions in almost all the important industries. There was only one industry in which they did not succeed in doing so and that was in steel. That industry was powerful enough to resist the demand of the United States Government during the War for the insertion of a standard clause in its government contracts recognizing the right of the workers to organize for collective bargaining. Throughout the War, the Government required this clause of every industry or firm from which it bought material.

But in practically all of the important industries, the workers had again taken to organizing because of this intervention by the Government. When the War was over, the employers again introduced an open shop campaign called the American plan and spent millions of dollars - it was estimated that they spent $7,000,000 to break up the unions and to sever this collective bargaining relationship. So we find again a situation where unions are practically eliminated from the important industries. In a few important industries like the railroad industry, the operative end especially was solidly organized, although among the shop men there was a strike in 1922 which the unions lost and which led to the introduction of company unions in some of the most important railway systems in the United States. In general, then, the unions were eliminated in the important industries because they had to stand on their own feet, so to speak, and I think it is fair to conclude that with the powerful firms that we have in the United States, with large resources, and with the strong organization among the employers, unions could probably not exist, especially in the so-called mass production industries, unless they had some aid from the Government.

I am personally convinced that the strength of the unions in Europe is not entirely traceable to their own economic power. I think a great deal of the strength of the unions in Europe is also traceable both to their political power and to the fact that the Government has from time to time intervened to give them a hand when they encountered a serious crisis in their conflict with powerful employers or with powerful employer associations. And I am almost sure that insofar as the United States is concerned, it will be very difficult for the workers to establish unions without Government aid, in the important industries where 8 or 10 or a dozen firms control the bulk of the industry.

There were various theories behind present day Government intervention in labor relations and I want to enumerate a few of them. The one that was undoubtedly the most important - the one that received by far the greatest attention - was the idea that there ought to be equality of bargaining between the employer or employers and the workers. Take the case of these big corporations. They, of course, have specialized personnel departments, highly paid and highly trained people. They have their bargaining specialists who hire, who direct labor. It is generally recognized, therefore, that the workers ought to have their own organizations through which they can bargain on a relative equality with the employers. That is what is meant by equality of bargaining in labor relations.

The idea, as I mentioned before,

has become quite current now. Take the United States Steel Corporation as an example; in this company Judge Gary has always taken the position that it was absolutely opposed to any form of collective bargaining. Judge Gary as a lawyer explained it on legalistic grounds, saying that the only way that anybody could have a voice in management is by owning property. The United States Steel Corporation, you remember, began selling stock to its employees, telling them that if they became stockholders, they would naturally have a voice in the management of the concern.

The United States Steel Corporation since the N.R.A. has reversed its position and now believes most ardently in collective bargaining. Although we have what might be called a popular acceptance of the idea of collective bargaining, we do not have a popular acceptance of the idea of collective bargaining on the part of workers through organizations that they themselves have founded, through organizations that they themselves direct, and which they themselves finance. We really have now in the United States a contest not over the question as to whether collective bargaining is desirable, but a contest as to whether we should have genuine collective bargaining or sham collective bargaining.

The purpose of the National Labor Relations Board is to see that the workers have an opportunity to participate in genuine collective bargaining. That is therefore one of the basic theories underlying the idea of Government intervention in labor relations as expressed through the Act. There is, of course, the question of safeguarding democracy of which you have heard a great deal. If we are to have political democracy, we must also have industrial democracy, and there cannot be industrial democracy unless the workers have organizations through which they can meet on a relative equality with the employers. The other idea is that if workers are organized, they will naturally be able to get better wages; they will be able to maintain better and higher standards of living than if they were not organized as they will have greater bargaining power.

One purpose of the Act is to reduce strikes. Statistics gathered by the United States Bureau of Labor Statistics show that, for instance, from 1901 up to 1935, from 17 to 46 percent of the strikes and lock-outs in the United States centered around the issue of what is known as union recognition. The employers refused to acknowledge that right and the only way in which the workers could attempt to force the employers to acknowledge it was by going out on strike. The Act if properly and effectively enforced would eliminate that type of strike, because it would cause the employer to recognize the right of the workers to organize, and to bargain collectively.

Now hand in hand with this is another idea which is used to justify the legislation on constitutional grounds, namely - the reduction of interference with the free flow of interstate commerce. The lessening of this burden upon commerce is, of course, one of the purposes of the Act. So much then, for the theory underlying the National Labor Relations Act. Studies show that employers resort to a variety of practices in order to prevent the workers from organizing into unions. It is not merely a matter of the employers simply saying that they will refuse to deal with unions; it is not a matter of the employers saying that they won't recognize the officials that are elected by workers and unions, but the employers in the United States actually resort to a variety of affirmative practices by which they prevent workers from organizing into unions, which is, of course, a much more serious matter and they have been quite successful in pursuing this type of activity.

One of these practices, for instance, is the black list. In certain industries a worker who is known to have been active in attempts to organize a union will find it practically impossible to secure employment. In the metal trades industries, which are among the basic industries, the employers' associations will maintain so-called labor bureaus, or employment offices. No one can get a job without going through those employment offices where his record is on file. If the record shows him to be what they call a labor agitator, or to have been in any way assertive or active, he just can't get a job. It isn't a simple matter to get evidence of this for all the information is sent out confidentially. But even if a victim could get the proof, he would have no legal redress because the courts have ruled that the black list is legal.

The hearings recently held by the subcommittee of the Senate Committee on Labor and Education, under the chairmanship of Senator LaFollette, have revealed the astounding extent to which employers hire labor spies. The business of labor spies, as you know, is to snoop upon their co-employees, who take them as being only fellow workers, and not as stool-pigeons or detectives.

You have read, probably, if you followed those hearings, that there are organizations functioning throughout the United States making large profits out of this particular kind of business. And among them are some of the more reputable detective agencies, such as the Pinkerton and Burns firms. And there are others that you may not have heard of. They have offices all over the United States and they specialize in hiring out people to employers to snoop around and act as stool pigeons among their fellow workers, who innocently go on trying to exercise the freedom of speech and other civil liberties which are supposed to be guaranteed them by the Constitution. These people are of course the ones that are 'spotted' and black-listed.

There is also the "yellow dog" contract. The employers have required workers, as a condition of getting employment, to sign a contract that they will not join a labor organization during the time that they are working for the particular employer. Now, that may not mean much in general, but it has some very interesting implications. Quite often, in this contract the name of certain labor organizations will be stipulated in addition to the general phrase. If an organizer for a labor group, later comes around and tries to organize these workers, he is of course, trying to induce them to break a contract and is therefore subject to being enjoined, prosecuted fined, and so on. You can see that a contract of that kind is a very important weapon in the hands of an employer in preventing his workers from organizing. Those contracts have been used very generally in the more important industries. They are now outlawed by the new type of legislation along with discrimination and discharge for union activities, fostering of company unions, and other unfair anti-union tactics. All of these practices, now outlawed by the National Labor Relations Act, were, of course, outlawed under Section 7A of the N.I.R.A. and are also outlawed in what is known as the Railway Labor Act of 1934.

There has been a good deal of dispute as to what group in a plant, for instance, can come together and organize on a collective bargaining basis. Under the Act, the Board is empowered to determine what the appropriate collective bargaining unit is in any given case. The Board is empowered to hold elections within the appropriate unit, so that the workers by a democratic process may decide for themselves who is to be their spokesman, and what organization is

to represent them in collective bargaining. The Board, according to the Act, must then enforce the results of the election according to the wishes of the majority.

There was a good deal of confusion during the NRA as to whether proportional representation orthe majority rule should be the basis for the designation of representatives. The National Labor Relations Act provides however, that the majority of those voting are the ones to decide which organization is to represent the workers, and who are to be their spokesmen. According to the proportional representation plan, a minority would have separate representation. Such a practice would raise a great many complicated factors. There must be one agreement; wage rates must be uniform. Otherwise you can see what opportunities for discrimination would be given to the employer. If there were two bargaining groups, that is if the minority were to have one and the majority another, the employer would be in a position to play the two groups against each other. There would be no uniformity of employment conditions, and this, of course, would create chaotic situations and upset the whole intent of the Act, to bring about a collective bargain.

The law therefore specifically provided for majority rule, and the majority accordingly designated the workers' bargainers. The minority may have an organization for handling the different grievances of those who want to belong to that organization, but not to determine the conditions of employment. If a worker has an individual grievance, and he doesn't want to handle it through the union, he may take it up himself with the employer or he may take it up through some minority organization to which he belongs which the employer may recognize if he chooses to.

To that extent, the minority is given an opportunity to function. But it cannot participate in the making of an agreement relating to wages, hours, or working conditions. That must be made by one group in order that there should be this uniformity, and that the employer may not take advantage of the division among the workers. This, of course, is the democratic procedure which we follow in our governmental set-up, as well as in other social organization.

With reference to enforcement, the Board has the same powers as the Federal Trade Commission. When there is a conflict, when there is a difference of opinion, the Board is authorized to hold hearings. It is authorized to take testimony. And it is authorized to make a decision. If the employer refuses to abide by the decision, then, of course, the Board is empowered to take the matter to court. The testimony taken by the Board is then presented to the courts for review and final action.

What about the accomplishments of the National Labor Relations Board? It has been functioning since about last September. The Act went on the statute books in July. Then came the question of selecting the members of the Board, of organizing, and so on. The Board did not actually start to operate until after Labor Day. And then it, of course, was immediately beset by a great many difficulties and a great many obstacles.

But before I talk about those I want to take up some of the Board's accomplishments. These are not very great, because of the obstacles that it encountered as a result of the legal difficulties raised by the employers. Up to the first of March, the Board had 729 cases involving 165,792 workers, a relatively small number when you consider that the bulk of the workers in the United States are at the present time not represented through unions recognized by their employers. But there were that many cases that did come before it. The Board has succeeded in adjusting about a third of these cases without holding any formal

hearings. Some of them were dropped for lack of proof of the charges. Among those that remained about half were based upon the charge that the employers had resorted to unfair labor practices; the other half upon the failure of the employers to bargain collectively with the workers in good faith. These two issues are the ones that are important.

The cases where the Board has succeeded in securing compliance have for the most part been those relating to the smaller employers. But most of the latter have accepted the intervention of the Board and have either made settlements or have contested the charges made against them, submitted to hearings, and then accepted the decision of the Board.

The powerful employers, and of course they are the ones that have been opposed to any form of genuine labor organization and collective bargaining, are the ones that are now challenging the Board and refusing to abide by its decisions. They challenge it on the ground of constitutionality. They say that the Act is void, and so whenever the Board attempts to hold a hearing they resort to one of two procedures. They may apply to the Federal Courts for an injunction saying that the intervention of the Board will cause irreparable damage and therefore inflict substantial losses upon them and so on. This plan was quite successful at the beginning; or, upon the advice of a group of lawyers who believe that the Federal District Courts cannot issue injunctions in these cases, they may appear at the hearings ordered by the Board, and you might say, read the riot act to the Board about the unconstitutionality of the law as enunciated by the lawyers' committee of the Liberty League, and then walk out, without further participation in the hearings. Thus the employers will either go to the courts and apply for injunctions, or come and read a nice, little statement that the law is unconstitutional and then walk out. The powerful steel companies are among those using the latter tactic.

Whatever hearings the Board has held, with one or two exceptions, have therefore been exparte hearings, in which the employer refused to appear or be represented. In such cases, if the Board renders a decision, the employer of course appeals.

So we have the big problem of the attitude of the courts. That is the one we are confronted with at the present time. At the beginning, most of the Federal District Courts issued injunctions restraining the Board from acting on the ground that the Act is unconstitutional. More recently the tide has turned. The Federal District Courts have refused to grant injunctions and have begun to make the statement that the Board has a right to hold hearings, and call elections. Some of them have gone so far as to indicate that the law is constitutional.

Now the next problem of course is the Circuit Courts of Appeals, because they are the court of first instance. The Board felt that in order to serve its functions and to perform its duties properly, it ought to make a special effort to get decisions from the Circuit Courts of Appeals as soon as possible so that a case might be brought before the United States Supreme Court in the present term. In these efforts it was unsuccessful.

The first case to come up before a Circuit Court was heard the 31st of March. The presiding judge announced that the Court will not be in a position to render a decision until some time next fall, perhaps even a little later. Another case was argued in San Francisco a week ago Thursday, and there is a possibility that we may get a rather early decision. There are several other cases pending in the Circuit Courts of Appeals. By next fall there will be a number of decisions handed down by these Courts, giving us some sort of inkling as to what we may expect. The Act then has to run the gauntlet of the United

States Supreme Court.

I can only tell you what the speculations are as to the outcome of this litigation. One of them is that the Court may declare the Act constitutional but limit the Board's jurisdiction to the very small number of industries that are engaged in transport and communication, thus exempting the basic mass production industries. That is one of the prognostications and it is the attitude those District Courts, which have gone out of their way to say that the law is constitutional, have hinted at. They base this view entirely on the Texas-New Orleans case which upheld the constitutionality of the Railway Labor Act.

Another feeling is that the law will be thrown out completely, if not on the interstate commerce point, then on the due process issue raised by the alleged interferences with the employers' right to free exercise of his property and so on.

The real clue we may probably get next Monday afternoon if the Supreme Court sees fit to hand down a decision on the Guffey Act. Then we may have an idea as to what is in store for us. The labor provisions in the Guffey Act are not similar to the labor provisions in our Act, because the Guffey Act regulates hours of work, wages, and other conditions of employment. Our Act as I have already said, merely protects the worker in the exercise of his right to organize for collective bargaining. Hence even if the Guffey Act is held void, there may still be some hope for us. But there may be some clues in the way the decision is worded as to whether we are to look for other jobs after next fall or whether we can count on making a lease for another year.

DISCUSSION

Question - What proportion of the situations that come before the Board are based on company union issues?

Answer - There have been some, but not very many on that issue directly. Indirectly it may be involved when a complaint of unfair labor practices is made - that is, the company's union may be functioning there and may thus be brought into the picture. I suppose if the Supreme Court upholds the Act, we may look forward to a very large number of such cases. The National Mediation Board, if we may take it as a criterion, has handled a large number of company union cases since the Railway Labor Act went into effect.

Question - Then the issue of company unions is not so great with the present Board's experience as it was with the Wagner Board?

Answer - It will become so once the Board's legality is established; that is inevitable, taking into consideration that in all the important industries, company unions are functioning. In the automobile industry, for instance, there were practically no company unions at all up to the time of the N.R.A., and now the company union is an accepted institution there. The same thing, of course, would apply to all the other important industries.

Question - How much does recognition involve? What is to prevent the big industry from going through a sham recognition with no intentions whatever of doing any real bargaining?

Answer - That is apt to happen, and of course, there have been a great many complaints, and it raises another important point as to whether

it will be possible to enforce the additional clause requiring the employer to bargain collectively with his employees. That will be a difficult problem. I think we can say this, though, that once it becomes impossible for an employer to break up a union and to engage in the various unfair labor practices which prevent workers from organizing unions, he will find it pretty difficult not to deal with them. I think that will take care of itself automatically. Once the workers are strongly organized and know that they are protected in their rights, the employer will find it pretty difficult simply to sit around a table with them and not to arrive at an agreement. The situation will naturally become impossible. The unrest within the plant and the general reaction will be such that he will find it desirable to bargain.

But the employer may get around this in various ways. Take, for instance, the period of the N.R.A. Employers got around it by saying that they would meet with committees, but they would put nothing in writing, which is, of course, not only meaningless, but a rather stupid position for employers to take since they ordinarily insist that every transaction be put in writing. I suppose that in a big firm if you want a dozen pencils you have to write a memo. But if you are dealing with a committee of workers, you don't want to put anything in writing. Many of these employers will accept only verbal agreements. Some have said they would put it in the form of a memo, which they would then hand down, which might be called a unilateral agreement. The employer doesn't want to recognize the unions. That is somehow to him a terrible thing to do. Some employers have agreed only to post notices on the bulletin board. The Boards have ruled that such arrangements are equivalent to written agreements.

It might be necessary to go thru a rigmarole of that kind for a few years before it would be possible to get a full-fledged agreement, which is in the form of a contract drawn up by joint negotiation and signed by both parties, and which both parties pledge themselves to carry thru. Once the workers are organized, these matters will automatically take care of themselves.

Question - I understand you to say that the greater number of cases settled by the Board since last fall have been in cases of small employers, and I was wondering if that was due chiefly to the fact that they felt themselves helpless to cope with the Board - that they didn't have the financial means to take legal action. Or was it due to the fact that they were more socially minded or enlightened than some of the bigger employers.

Answer - No one in any way questions the motives of either group. It is undoubtedly due to the fact that insofar as the smaller employers are concerned, the worker is a match for them when he organizes, whereas the steel worker who organizes into a union is no match for the United States Steel Corporation, and certainly no match for the Iron and Steel Institute. Nor is the worker in the meat industry a match for the four great meat packers. That undoubtedly explains it. The whole history of labor as I have given it to you before shows that these powerful employers feel themselves strong enough to deny the workers their civil liberties, for instance their right to organize. Perhaps the small employers look on with great envy, but they don't have the power and they must therefore submit. The real function of the National Labor Relations Board, at any rate the major function, is therefore to protect the interests of the workers in these basic industries against the powerful employers who feel that they are so strong that they can ignore everybody's rights.

At the present time, if you were going to make a study you would find,

with the exception of the railroad and some minor cases, that the areas where the unions are pretty strongly established are, of course, in those industries which have not yet reached the stage of integrated mass production. In general where the business unit is small, the workers who organize can stand up against the employer's opposition.

Even in the steel industry, the smaller, so-called independent steel companies have been dealing with the Amalgated Association of Iron, Steel and Tin Workers for a long time back. The biggest ones have not, and it is interesting to note what has happened since the mergers have been developing. Take a company like the Republic Steel Company which has been expanding. It has absorbed a number of smaller companies that have been dealing with the union. When they merge with Republic, relations with the union either become strained or are sooner or later broken off completely. Now the Steel Workers Union is no match for that kind of powerful corporation. The same condition prevails in other industries.

Question - Do the corporations refuse to arbitrate differences with their company union?

Answer - I think the United States Steel Company feels that way about it now. I don't know whether we can generalize about it, but they have said that there is no such provision vested in the company union constitution, that arbitration is not a function of a company union. Now, of course, the essence of collective bargaining is that both parties should come together and arrive at some agreement, and if they cannot arrive at an agreement, they either disagree and there is a lockout or strike, or there is arbitration.

The United States Steel Corporation has denied its workers the right to arbitrate. They therefore admit that the only function of a company union is that of a sounding board. The final decision is entirely with the management.

Question - What about the white collar or the sales workers? I have been especially interested in a plan for them at Filene's, and I thought probably it had several interesting developments or possibilities and at one time thought it would be desirable to have a general application of the ideas followed there. What do you think of their plans?

Answer - You mean the employee representation plan in Boston?

Question - I understand that they have a right to appeal and I believe that the management even goes so far as to reinstate the person even if he is against the policy of the company. They seem to be able to reinstate an employee who is unjustly fired if the employees themselves so decide.

Answer - That is one plan in which the workers have certainly had freedom of action. There are a few others of that type which are outstanding exceptions. That certainly would not characterize plans in general use so far as company unions are concerned.

Question - Is that due merely to the high type of worker, or would that be applicable to other workers?

Answer - Filene's deal with the Garment Workers Unions. It so happens that the department store clerks have not been well organized and so the question of these department clerks joining independent unions has not come up. But they certainly have had freedom of expression and are quite independent and know it. In that sense this would be one of the exceptions. There are a few others, like Mr. Dennison, a paper tag manufacturer. His plan also is a genuine and independent plan. Of course, the significant thing is that within one firm, naturally they are not strong enough to accomplish much.

They have to have the guidance and support of people who are specialists, and the worker who sits at the bench all day cannot develop into a specialist for bargaining purposes. No matter how good these company union plans are, there is no provision for the company union of one company to associate with the company unions of another firm or plant, so that they may pool their strength and interests and may select people who have the natural characteristics which make them good bargainers.

Question - I should like to elaborate on what you said before about no other country having labor spies. I think that there are no such organizations abroad because they have developed a finer art over there. The strikebreaker in Europe works for nothing. In England, during the general strike in 1926, the government, through its various agencies, organized volunteers who were glad to patrol the highways and to take care of the free flow of commerce. I never saw a general strike that looked so little like any kind of strike at all.

Answer - That happens. I wonder if that would happen in a coal strike, or a building strike, instead of a general strike? What you had there was a highly complicated situation, but I don't believe that it is such an easy matter to gather what are known as scabs in the case of an ordinary strike. It is just a question of who can hold out the longest, rather than a question of introducing labor spies or a question of organizing company unions.

Question - Don't you think that company unions may pave the way for genuine unions in the future?

Answer - I don't know whether we are warranted in generalizing. The company unions of the United States Steel Company have gone on a rampage and have declared themselves independent. They have called a meeting outside of the plant, and have even gone so far as to call upon the company for arbitration. The United States Steel Corporation, in spite of the fact that it has a very highly specialized and high salaried personnel manager, was baffled, and had to admit that these company unions are not collective bargaining agencies, which of course had been claimed by organized labor and by the union people all the time. The demand for arbitration was rejected on the ground that there was no such provision in the Constitution of the company.

Question - How many workers must a company have in order to come before the jurisdiction of the Board?

Answer - As long as it is within interstate commerce, the number of workers is no factor. The important thing is whether the firm is engaged in interstate commerce.

Question - Does the law provide for any special protection for the employer, for instance, in the case where the employees could unite so strongly to raise wages so high as to take all of the profits?

Answer - That of course would be a vital social question that would have to be decided when it arises. At the present time it is not even academic, so you see there is no need to act upon it.

TRANSPORTATION

By
Joseph B. Eastman
Federal Coordinator of Transportation

The subject which I am to talk about is transportation, and I might say that I am confronted with three difficulties. One is that it is such a large subject that there is much of it that I do not know about; the second, is that in the time available I can not tell even that which I do know; and the third is that I have made very scanty preparation for this talk. What I shall say will be selective, and I shall try and discuss some of the matters which are of current interest at the present time.

I think that the most outstanding thing in regard to transportation at the present time is the tremendous change which has taken place within very recent years. In 1920, it was estimated that the railroads represented an investment of something like twenty billions of dollars. Since that time the best estimate we have been able to make is that there has gone into forms of transportation which are competitive with the railroads, and do not include local transportation, about an equal sum of money, and that in the meantime the railroads have also increased their investment by about six billions of dollars.

Another outstanding thing is the tremendous slump of railroad earnings which has taken place in the depression. In 1932, railroad revenues were about 51 percent of the average revenues for the 1923-25 period; in other words, the slump amounted to about 50 percent. The railroads in the past have gone through a great many financial depressions but in none of them have they ever suffered such a slump in revenues as occurred during the present depression. Even in 1935, their revenues only amounted to $56\frac{1}{2}$ percent of the 1923-25 average. That was due, of course, in large part to the tremendous severity of the depression, probably the worst depression which the country has ever experienced, but it was also due in considerable measure to the growth of these competitive forms of transportation.

We do not know just how much traffic the railroads have lost to the other forms of transportation because there are no statistics as yet available. It is impossible, for example, to know at all accurately how much traffic is carried by trucks including not only the common carrier trucks but the operations of private trucks. However, we do know that the railroads have suffered severely from this competition, and that is particularly true in the case of passenger service. In 1935, the loss in passenger revenues in comparison with the period ten years ago was about 67 percent, and the loss in freight was about 38 percent. A great part of the loss in passenger traffic has been caused by the private automobile, but, on the other hand, the private automobile has tremendously increased the travel habit of the American people. According to our best estimates, in 1929 the automobile was carrying in inter-city transportation, stated in terms of passenger-miles, a volume of traffic which was about five times that ever carried by the railroads in the past.

Looking back over the past, it is a little difficult for me to

realize that I can remember when the first trolley cars were introduced, at a time when in New York City they were still operating only horse cars; and of course I can remember the first automobile, and the first Wright aeroplane. The trolley cars are now gradually disappearing, although at one time an investment in a good city electric railway was regarded as about as sound and conservative an investment as one might find. On the other hand, we have this extraordinary development in highway transportation. I can also remember the time when an ordinary water-bound macadam road was a rarity even in the eastern part of the country, and now we have hundreds of thousands of well paved highways spread over the entire country, and on them millions of automotive vehicles operating at express train speeds. It merely shows the tremendously rapid progress which has been taking place in transportation and also what you may expect in the future. From my own point of view, I believe that the progress in the future will continue at an accelerating momentum in comparison with what it has been in the past.

Now, not only has this competition affected the railroads adversely in the volume of their traffic, but it has, of course, had an effect upon their rates. Comparing the 1935 rates with those that were in effect in 1928-29, we find there has been a decrease in the average ton-mile revenue of the railroads of about $11\frac{1}{2}$ percent, and a decrease in the average passenger-mile revenue of about 35 percent. That is very largely due, of course, to the competition of the other forms of transportation, and this process is still going on, as can be seen by the reductions which are about to take place in the passenger fares on the eastern railroads. Out in the West two years ago they reduced the fares to two cents a mile, and in the South the rate went down to $1\frac{1}{2}$ cents a mile, Now the eastern railroads are about to come down to the 2-cent level.

The slump in business, of course, has also had an effect on the employees -- a very great effect. In 1920, railroad employment reached a peak with 2,197,000 employees; after that it began to fall off, and fell quite sharply, until in 1930 there was a nose dive in the number of employees and in 1933 the bottom level was reached, when there were only 970,893 employees compared with over 2,000,000 in 1920. Of course, the attitude of the employees towards labor-saving devices has also been greatly changed by that situation. Ever since the railroads started operating, they have introduced labor-saving improvements of one kind or another, either of a mechanical type in their motive power and equipment, or in the tools which they use, or consolidations and unifications which have brought about a shrinkage in labor; but until 1920, so far as the employees were concerned, the trend was always upward notwithstanding these changes. Since then it has been downward, which, of course, has given the employees a considerably different attitude towards labor-saving improvements. However, this does not mean that the total number of persons engaged in transportation has decreased; in fact, even at present it is probable that more persons are engaged in transportation than were engaged in it in 1920, due to the tremendous increase in highway transportation. Relatively, in proportion to the load, the highway carriers employ more workers than the railroads do.

These changes which have taken place in the transportation situation, of course, give rise to two questions. One is what shall be done about the railroads, and the other is what shall be done about the other forms of transportation. I shall take up the railroads first. It seems to me quite clear that the changes which have taken place and those which are impending will make it necessary for the railroads to

progress steadily in the direction of better service and lower rates, not only in their passenger service but also in their freight service, and that in order to bring these about it will be necessary for them to strive continually towards greater efficiency and economy in their operations. That is going to be their salvation -- to bring about changes of that kind.

That brings me to a subject in which I have a personal interest, and that is the act which was passed in 1933, called the Emergency Railroad Transportation Act. The theory of that act at the start was that because of the fact that our railroad system is owned and operated by a very large number of separate and independent companies, a great amount of waste occurs in railroad operation which could be avoided by greater cooperation on the part of those separate companies, and also by greater coordination of their various operations and activities. It was felt that so far as that might have an effect on competition, such an effect would not be so serious as it might possibly have been in the past, because of the fact that all this competition now exists from the other forms of transportation. It was further felt, at that time, that while this waste could be eliminated by actual consolidations of the companies into a very few systems, the easier and the better way would be to bring about coordination of separate operations and activities where the railroads have a common interest, without endeavoring to force consolidation into a very few great systems, which would not only have great practical legal difficulties, but which would also be open to other very serious objections.

Under that Act, it was the theory that the railroads should go forward and do these things on their own account and to that end the Act set up three regional coordinating committees of the railroads, one in the East, one in the West, and one in the South. It was made their duty to see to the elimination of waste along the lines indicated in general terms in the Act. However, it was realized that because of the operation of interstate laws, Federal, or State, or other prohibitory statutes, obstacles might arise which would prevent the accomplishment of some of these projects, and it might also happen that while a majority of the railroads in any given situation would agree to what was proposed, there would be a minority that would object and make accomplishment impossible. Therefore, a Federal officer was set up, called the Federal Coordinator of Transportation, and he was given authority to issue orders, if he found the public interest so required upon request of these coordinating committees. Before the Act was finally passed, the coordinator was given power of initiation; he could refer matters to the coordinating committees and if they did not act within a reasonable time, he could issue orders on his own account.

However, a situation arose before the act was finally enacted which had a very serious effect upon actual accomplishments under it. At that time, Congress was considering the National Industrial Recovery Act, and the stated object of that was to put more people to work, to increase employment. The employees of the railroads very quickly saw that the elimination of waste in railroad operations also involved, to a very considerable extent, the elimination of labor, and they at once said that these two objectives were inconsistent; on the one hand you had a bill which was seeking to put people back to work, and on the other hand you had a bill which was seeking to deprive them of work. Presenting that argument -- it had

much logical force -- they succeeded in having amendments put into the bill which protected those employees who were in the service on May, 1933. They provided that nothing done under the act should deprive men of such employment as they had, or impair the compensation that they were receiving, at that time. The effect of this amendment was to totally destroy the enthusiasm of the railroads for the Act, and they were disposed to remain quiescent.

Therefore, the Coördinator found it necessary to proceed under his own steam, so to speak, and upon his own initiative to a greater extent than had been anticipated originally. I was selected for that job. I am still a member of the Interstate Commerce Commission but have been relieved largely from duties as a commissioner while occupying the office of Coördinator. It seemed to me that it was highly desirable to make studies of what was possible, what could be done in the way of coordination for the purpose of increasing efficiency and economy of operation, and also to construe the word "waste" broadly and inquire into what could be done by the railroads in the way of improving service, operation, equipment, and rates, with a view to meeting the new transportation conditions which suddenly had been forced upon them by the rapidly increasing competition in these other forms of transportation. And we undertook to make studies of both of these things while we had but a very small force; the railroads coöperated very well indeed; we also had the help of shippers, state commissions, Interstate Commerce Commission, other forms of transportation, and many others.

Perhaps I can give you an indication of some of the things developed by those studies by reading something that I said before the Engineers' Society of the Lehigh Valley recently. I undertook to indicate what I saw in the future so far as the railroads were concerned.

Giving you a picture in broad strokes of some of the things that are coming, if I am at all right about it, I can see a central scientific, engineering, and economic research department acting for all the railroads, able to establish within proper limits standards for equipment, construction, materials, and supplies, not too rigid or difficult to change, but which will prevent the great and unnecessary diversity of types which now adds heavily to costs. This department would also, as similar departments in other great industries have been able to do, keep the railroads not only abreast but ahead of the times, produce inventions as it were to order, and furnish the means of testing new and promising developments at common expense.

I can see many of the freight cars of the railroads, which move in free interchange all over the country, handled in a common pool so that they can be utilized with much less waste motion, just as the Pullman cars and to some extent the refrigerator cars are at the present time, and so that purchases of new equipment may be financed to maximum advantage and made in the orderly manner and at the appropriate times which will reduce manufacturing costs.

I can see the very complex and costly methods which now prevail in the handling of intercompany transactions, such as the dividing of joint rates, simplified and expedited by the establishment of a central clearing house.

In the larger places, served by two or more railroads, I can see the present confused, costly, and time-consuming terminal operations greatly simplified and reduced in volume and expense by unified utilization of all or some of the facilities.

I can see joint use of some shops, where conditions favor it, and a gradual raising of shop equipment and methods up to the high standards which now prevail on some of the railroads, but by no means all; and I can see similar progress in the handling of materials and supplies and the disposition of scrap and waste material.

When it comes to passenger service, the very marked advance which is being made in the air-conditioning of coaches and in their seating and other accommodations will be followed up by many other steps which will add to the comfort and convenience of the service. Attention will be concentrated to a much greater extent than heretofore on the customer and what he needs and wants. To provide service of greater frequency and flexibility, single-unit cars propelled at low cost by gas or Diesel power with some form of mechanical or hydraulic or electric transmission will in many cases by employed, and they will be adapted to multiple-unit operation. To achieve light weight, new metals and methods of construction will be used. Passengers will be given collection and delivery service to and from stations. Advertising and other means of marketing the service will be improved and developed, and often employed by the railroads collectively. Station accommodations and service will be made more convenient and attractive. The trend of fares will be downward. Busses will be used in many situations to augment or supplement, and in coördination with, rail service.

In freight service, I can see the less-than-carload, express, and car-forwarder traffic combined, concentrated, and handled in much more heavily-loaded cars of shock-proof construction, moved at passenger-train speeds. The distribution at either end will be done by trucks, probably to and from railheads usually located outside of the crowded city areas. An intermediate service, between the present less-than-carload and carload services, will be developed by the use of containers carried on flat cars. They will be of lightweight construction, of uniform types, and capable of interchange between all railroads, and between railroads and motor trucks or water carriers. Some of them will be adapted to special services, including refrigeration.

In freight service generally, the tendency will be towards faster and more frequent operation of trains, although heavy tonnage train will continue to have their place. Steps will be taken to reduce the heavy costs and delays which now characterize terminal operations, these steps including not only unified use of various facilities, but a more extensive use of motor trucks. These will also be used to a greater extent in substitution for local way-freight and branch-line operations, although there will be a development for rail use of lightweight motive-power units having a similar purpose. The unification of terminal facilities and the greater use of trucks in such service will probably release from railroad use, in due course, considerable land in crowded city areas which can be sold with profit.

In many situations where unnecessary duplicate or multiple operations are now conducted, in both the freight and the passenger services, there will be a pooling of operations; but instead of depriving the public of accommodations, the tendency in such arrangements will be to give a better balanced and more convenient service.

I can see a gradual revision of the freight-rate structure. It is the product of conditions very different from those which exist today. There are wide variations in the

relations which rates bear to cost of service, and the whole structure is full of unutterable complications. Only an expert can interpret most railroad rate tariffs, and he may not always succeed. The tendency will be toward simplification of rates and a closer relation to cost of service. This will be forced by the competition of the other forms of transportation, including private carriage. Cost-finding systems will be introduced or expanded for use on the railroads, not only in connection with rates, but also to obtain a closer check on expenditures. The general tendency of rates will be downward. When such adjustments in rates as can be justified are made and railroad service becomes as efficient and economical as is possible, I now see little future for long-haul motor-truck haulage of most commodities, although I expect to see the shorter-haul operations expand continually.

These are some of the things which lie in my mind with reference to the railroad future. Others will have a different picture. No one can be sure of anything, except that there will be many and important changes, and that some of these will not be foreseen at all.

There is another situation in connection with the railroads which has created difficulties for them in the depression times. Of course, most of them are old institutions. The history of many of them goes quite far back into the past, and some of them were over-capitalized at the start, and in many cases - most cases - it has been the practice to finance to a very considerable extent by the issue of bonds bearing fixed charges. Of course, when the depression brought about the severe slump in earnings, operating expenses could be cut down to meet the decrease in the traffic carried to a very considerable extent, and were so dut down; but when it came to the fixed charges, they could not be decreased. The only way in which you can decrease your fixed charges is to get in the position where you can not pay them, whereupon you are taken into court, and you have an opportunity to reorganize.

Now, with respect to that fixed charge situation, the situation and the conditions are these:

At the close of 1935, 88 steam railroads were in receivership or bankruptcy, operating 69,008 miles of road, or about 27 percent of the total. More than $2,500,000,000 of railroad debt was in default as to interest, and there was more than $6,500,000,000 of railroad stock on which no dividends were paid during the year. Railroad credit can be helped materially by the financial reorganization along sound lines of the railroads now bankrupt and of others which may meet with similar difficulties. But it would be a mistake to assume that any such process, however far it may be carried, can do away with the need for the utmost economy and efficiency in operation. Neither the passenger nor the merchandise traffic nor a large part of the carload freight traffic has for some years been paying its share of operating expenses. Moreover, whatever allowance may be made for past financial exploitation and for obsolescence and other forms of depreciation, there remains a great investment in railroad property which is entitled under the law to a fair return and on which in the long run a return must be earned, if the industry is to be conducted successfully by private enterprise and capital, or indeed under any system of public ownership which will not burden the taxpayers.

The situation may also be helped materially by the present tendencies of interest rates to go downward. Railroad debt matures and there are opportunities on such

occasions to refund it by the issue of other securities. Some of the railroads have recently found it possible to take care of such refunding operations in a way which has materially decreased their interest charges. The Union Pacific has been able to finance about $16,000,000 of bonds matured on better than a $3\frac{1}{2}$ percent interest basis, and the Great Northern has recently been doing that on something like a 4 percent basis, largely through the good offices of the Reconstruction Finance Corporation, which was enabled, without any burden on itself, to produce that result, contrary to the desires of many of the bankers.

I have referred to the labor situation and what happened when the Act was passed. Looked at from a long range point of view, I think there can be no question that it is in the interest of railroad labor that the railroads should be enabled to operate just as cheaply as they can, consistent with public safety and the maintenance of fair wages and good working conditions. In other words, the railroads have to meet the competition of these other forms of transportation. Only by getting the cost down, improving the service and giving better rates, can they hope to expand largely in the future and increase the amount of employment. But, looked at from a short range standpoint, of course the process of bringing the costs of operation down may, in some cases, affect labor very severely and produce serious hardships, as men are displaced and laid off for the time being.

I have felt for some time, and have so argued, that this ought to be taken care of by a system of dismissal compensation which would tide the men over in such situations and prevent these hardships. Recently, at the request of the President, the railroad managements and the railroad employees have been negotiating with a view to arriving at an agreement for the handling of this matter. For a long time it seemed as though those negotiations were going to meet with failure, but they were renewed on Thursday of this week and I believe the prospects are not excellent for reaching a settlement satisfactory to both sides. Probably the arrangement which will be made will take the form of giving the displaced employee a certain percentage of his prior earnings, something like 60 percent or 66 2/3 percent of what he was previously receiving, for a period of years, having some relations to his past length of service. It might, for instance be five years in a case where a man had been there a long time, and it might be a lesser period in the case of a man with shorter employment. And he might be given an option of taking a year's pay and leaving the service, if he saw fit. The hopeful thing about that situation is that there is a regular attrition in employment,

amounting to about 5 percent a year, due to retirements for normal reasons such as death, disability, old age, etc., and, in addition to that, in a period of increasing traffic employment rises as the traffic increases. If some of these changes could be made under such a system of dismissal compensation, in a period of rising traffic particularly, it is quite probable that the railroads would get the full benefit of the economies in a comparatively short time and in the meantime the employees would be protected against any undue hardships. So much for the railroads.

Now we come to the second question, what to do about the other carriers, the other forms of transportation. Some of these other forms of transportation until recently have not been regulated at all by the Federal Government, whereas, as you know, railroads are subjected to a very comprehensive system of public regulation. That regulation extends over their rates, to some extent over their service, over the issuance of securities, over accounting, over consolidations and other forms of unifications, etc. In the case of rates the Commission can not only prescribe maximum rates, but it can prescribe minimum rates, and it can suspend changes in rates pending investigation.

As a result of that situation, when the railroads came to meeting the competition of these other forms of transportation and propose reduction in rates, the other carriers, such as the motor carriers or the water carriers, could come before the Commission and protest, and ask for a suspension and the fixing of minimum rates. They not only could do that, but they have done it frequently. Frequently we have had protests by water carriers and motor carriers against changes in railroad rates, or against existing railroad rates. Railroads had no such opportunity in the case of other forms of transportation, and the latter were able to do what they saw fit, and were not prohibited from discriminating between the shipper who had the largest amount of traffic to offer them and the shipper who had a small amount of traffic. The result of that was, of course, that the railroads protested vigorously and with a great deal of reason. They said that either they ought to be regulated less and the shackles taken from their hands, so far as competition was concerned, or the other forms of transportation ought to be put under comparable regulations.

One of my duties as Coördinator was to consider and recommend any changes in legislation of a more permanent character than the Emergency Act, which ought to be made for the improvement of transportation conditions. After studying the transportation situation, I concluded that it would not be wise to relax railroad regulation to any great extent, but that the wise thing to do would be to bring the other forms of transportation under more or less comparable regulation.

Motor carriers were not being regulated by the Federal Government, though they were by many of the States.

Water carriers were regulated only in part. Some of their port-to-port rates are not subject to any regulation and such regulation as there is is divided between the Interstate Commerce Commission and the Shipping Board. Air carriers were subject to no Federal regulation except that of the Commerce Department with respect to safety.

Of course, in any system of regulation, it should be conducted in accord with the peculiar transportation conditions of the particular agency which you are regulating. In other words, it would be a great

mistake, unfair and unwise, to regulate motor carriers as though they were railroads. They must be regulated with a knowledge of their own peculiar conditions and with a view to preserving for the public the numerous advantages of their particular form of transportation. Exactly the same thing is true of the regulation of water carriers. I came to the conclusion that if there were to be regulation of all important forms of transportation, it ought to be centered in one body, in order to prevent conflict of authority and confusion, and also that this body should be the Interstate Commerce Commission. But I further concluded that the Commission ought to be reorganized into divisions for the purpose of specializing on each form of transportation and at the same time securing a coordinated policy covering the entire system of regulation.

My recommendation in the latter respect has not, as yet, prevailed. However, the Motor Carrier Act was passed last year providing for the regulation by the present Interstate Commerce Commission of the motor carriers. An interesting thing about that to me, however, - perhaps the most interesting thing - is that the Act was favored by a very large percentage of the motor carriers themselves, because of the chaotic conditions developing within the field of motor carrier operation. Of course, the railraods wanted the regulation of the motor carriers, but that Act would never have been passed had it not been for the support which was finally given to it by a large percentage of the motor carriers who felt that regulation was necessary to stabilize the conditions in their own industry.

The difficulties of motor carrier regulation are very great indeed. It is entirely different in many ways from the regulation of the railroads. The railroads are large and well-organized enterprises. Motor carriers are many of them very small operators. I think probably the larger number of them operate no more than a single truck, and operations of two or three trucks are very common. How many of them there are that are subject to the Act we do not know yet with any precision. Under the new Act, nearly 100,000 applications for certificates or permits have been filed. However, it is probable that some that have filed those applications are not subject to our jurisdiction, and on the other hand, it is exceedingly probable that a good many who should have filed have not filed any applications.

We have the tariffs on file now, beginning April 1, and there are as many as 40,000 such tariffs filed by motor carriers. Very many of the tariffs, however, were filed by an agent representing a group of carriers, so that the number of tariffs does not indicate the number of operations.

Now, in order to regulate carriers of that kind you have got, of course, to establish a system so that you can maintain contact with them - locate them. It is a very difficult thing to locate a motor carrier, whereas it is easy to find a railroad. Not only that, you have to adapt your regulations to their abilities. You can't expect the operator of a single truck to conform to any elaborate requirements. You have got to simplify them so that it is something he can do. Requirements must meet the needs of the larger and well-organized companies, such as the Greybound Bus Company, but be capable of contraction to meet the abilities of the little operators.

In our administration of that Act, we have been endeavoring to keep these difficulties in mind. We have established a Bureau for motor carriers separate and distinct from

all other departments of the Commission, so that the staff working on that problem would not be a staff which had grown up in railroad work and was more accustomed to railroad problems than to motor carrier problems. The men we have selected have been men with special knowledge and experience in motor carrier operations. We also have to set up a field organization extending all over the country, with sixteen different districts, for the purpose of maintaining contact with these operators, not only policing them, but helping those who want to abide by the law, and we believe there will be a great majority of them who want to comply. In other words, checking them, helping them and training them, because many of them will need such help.

The Commission is still in the throes of organization, so to speak, although the work is getting rapidly under way. There are many things to do - safety regulations, insurance regulations, traffic regulations, etc., and you can not force those too rapidly upon these companies, making too great a burden at the outset. There are also a number of legal questions which have arisen.

In the case of the railroads, regulation began in 1897 and did not reach its climax until 1920. There use just as many legal questions in connection with railroad regulation, and perhaps more than in connection with motor carriers but they were dealt with gradually. Here the Commission is being called upon at one jump to undertake a full-fledged system of regulation of an industry that has sprung into being like a mushroom and in which the conditions are very chaotic indeed.

I recommended an Act for the regulation of water carriers by the Interstate Commerce Commission and that is still pending in Congress and has not been acted upon. In addition to that, since I have been Coördinator, I have had something to do with the passage of the amended Railway Labor Act, providing for mediation in labor disputes and regulation of labor affairs with respect to company unions and questions of that kind, and also with the passage of an amended Railroad Bankruptcy Act providing what we regard as a better system for the reorganization of bankrupt railroad companies.

TARIFF MAKING IN THE UNITED STATES

By
Robert L. O'Brien
Chairman, Tariff Commission

I feel very much today in coming into this beautiful auditorium like my friend, Mr. Louis Perry, who is principal of the Phillips Exeter Academy, - like his experience when for the first day he became a professor at Williams College in his youth. He said he came into the classroom and told the students that the plan of procedure was for him to lecture for forty minutes and then the lecture over, the remaining twenty minutes would be devoted to class discussion and to questions which members of the class might raise. At the end of forty minutes, when he had told everything that he knew on the subject he had chosen, everything that he could think of, and was sorely put to it for anything more to tell to the class, he expected to hear the class begin to ask questions, but instead of that, they went for the door with such speed as to remind me of what your presiding officer just said about this class coming in slowly. I feel they may go out more rapidly after I have finished speaking. At any rate, Professor Perry's class went out in tremendous and rapid fashion, and he was stumped, until he looked toward the door and found one young man looking around rather sheepishly as though he wanted to come in and didn't know whether to do so or not, and seemingly this one repentant sinner decided to come in. He stood first on one foot and then on the other and then he said to Professor Perry, "May I be allowed to ask a question?" "Yes", said the Professor, "that is what this period is for. I am glad to be of any possible help to you. Now what is the question you would like to ask?" Said the student, "it is this: Is there any possible way that I can get out of this class?" Which again was not a very encouraging reception to the new professor on his first day.

So I had the feeling as I approached this thing today that perhaps at the end of my talk, that would be the question that I would raise in your minds. However, since you have been courageous enough to come into this room on this warm day to hear an academic lecture like this, I want to do the best I can to try to tell you something of possible interest on this tariff question. I want to give you a little history of the organization and the purpose of the Tariff Commission, of what it is all about.

When I was of the age of you young people, and as the presiding officer has already told you, I was connected with the Government, I was a stenographer to Grover Cleveland - not his private secretary - someone else had that job - but just as a stenographer. Mr. Thurber was the private secretary.

In those old days, there was a great deal of discussion among reformers and progressives of all sorts in favor of taking the tariff business out of Congress and lodging it with a Tariff Commission. The most common comparison that was made was with the Interstate Commerce Commission. They were not very much alike, but it served as a talking point to take the tariff business away from Congress. The advocates of the reform said that the Congress of the United States does not prescribe the railroad fare between

Baltimore and New York and that they left such things, that is, the supervision of such things, to the Interstate Commerce Commission. They said, "why not leave to a corresponding commission the adjustment of tariff rates?"

Well, now, in my day that was the favorite dream of the reformers. I read recently Claude Bowers' "Life of Senator Beveridge", former senator from Indiana, and the number of letters and speeches and discussions that he had collected on the importance of setting up a tariff commission was extremely impressive to me. Of course, the arguments for a tariff commission are very simple. Other nations of the world make their tariffs through executive orders, and not in great legislative bodies. The Constitution has of course given the business of making tariffs, at least the origination of it, to the House of Representatives. As a result, our tariff building or making in the Congress of the United States has from time immemorial been stamped with a good deal of scandal.

I think that that phrase, even if taken down by your expert stenographers here, may not get me into any great amount of trouble.

Our congressional body is made up of senators from the different States and members of the House from districts. When a new tariff bill is under discussion, when the leaders decide they are going to have a comprehensive review of the tariff, - the various senators and representatives are wired by their constituents, who ask what they are going to get out of it. They are governed by what the industies in their districts want, and it is not an uncommon thing for a body of representatives as large as you are today, from districts with similar interests, let us say from the best sugar districts, to get together and say, "What tariffs do we want on beet sugar", and then they get together and go to the larger body and say, "Here's our schedule; this is what we want and what will be necessary", at least by implication, "to get our votes for the tariff bills."

Then somebody else who has a friend in Congress says, "Here's the schedule we want on watches", and then the question is for the various districts in the United States where watches are made, and there are a great many scattered throughout the country, to get together and say, "we want this watch schedule to go through, or we will not support the bill."

It has taken approximately a year to make any of our tariff bills and I heard a former Republican cabinet officer who was in the cabinets of both Taft and Hoover say that he had seen two administrations, those of Taft and Hoover, wrecked by the tariff bills passed in their administration. In other words, the congressional method of tariff making has its very serious obstacles along the lines - I have set forth.

Ever since President Wilson's day, with constant changing and adjusting, there has been a movement for doing this thing by means of a tariff commission. I am not an unmixed enthusiast on the tariff commission plan. Don't think I came here to try to sell you my wares or merely to explain to you the very great importance of the commission of which I am a member. The idea, roughly, is to take away from congressional log rolling the task of tariff making and have tariff making done by a judicial, scientific, impartial body. It sounds extremely good. It sounds as though it ought to be the right way to make a tariff. But there are serious objections.

How are we going to adjust the tariff between two countries? What shall the standard be? I don't propose to go back to the history of the

world to tell you this, but I will go back only a little way, namely, to the Tariff Act of 1930, the Hawley-Smoot Tariff Act. This tariff Act, under which we are operating now, carried in its section 336 the basic theory of the present tariff commission, until the enactment of the law with which Secretary Hull is identified, about which I will talk a little later.

When I came down here in 1931, I didn't know much of anything about the tariff, a state of mind in which I find myself often; President Hoover was a great believer in the cost-of-production theory of tariff making, that is, to have a scientific body ascertain the difference in the cost of production of an article here and in the chief competing country. That is the existing law. That is the section 336 of the Hawley-Smoot Act. I am going to tell you what has happened since, because it is worth while to remember that now. When I came down here, that was the chief job of the Tariff Commission, theoretically at least, to find out what was the difference in the cost of production of a commodity here and in the chief competing country and make the tariff cover that difference, to take it up and down as you raise or lower a window according to the way you want the air to come in. That got it the name of the flexible tariff. That sounds very good, and I think if you get into an enthusiastic group in most any of the clubs of the country today and ask them "Don't you want to have a tariff commission; shouldn't the tariff be such a figure that it would represent the difference in cost of production between the United States and that of the chief competing country?", they would answer in the affirmative, because it sounds well, because it "listens" well.

Well, now, I will tell you how I would answer the question. That is not what you want a tariff to be. Tariff is a matter of public policy, and if our people would tell you the exact difference in cost of production here and abroad, no one not omniscient could tell you that and that would not be the right basis for a tariff, because tariffs are matters of public policy and are dependent on what you want to do about them. Let me give you some illustrations.

Just after the repeal of prohibition, when the brewing of beer became legalized, there was effort being made to pass a tariff on beer which would be based on the difference between the cost of brewing it in Munich, Germany, and in Milwaukee. That would not have been enough to bring the brewing business back into this country, and everyone knows that it would have been a matter of public policy, what with our growing abundance of beer producing grains, to brew our own beer here. But if you had a tariff which was only the difference in cost of production between Milwaukee and Munich, our business in order to start up, with the beer business already going strong in Munich, - the difference in cost of production would not be so very great and would not be very sensational, and most of the beer drinkers would say, "Munich beer so much - Milwaukee beer so much, I guess I'd just as soon have the Munich, for a trifle difference in cost," and we would not have set our beer brewing industry back in business.

On the other hand, there is another commodity which experience has taught me I cannot mention the name of because the people who produce it are very sensitive about it. The man who is at the head of the interests behind this product want an increased tariff on it, and he wrote a friend in Congress complaining

about my lack of judicial quality in my using his article as an example.

I will merely tell you it is an agricultural commodity that will grow in this country, is grown in one of the largest States in this country, and also grows in a foreign country. It is a great ingredient in medicines. It has a great value to a certain group of troublesome diseases. It is a great element or factor in a medicinal preparation, and a great ingredient also in cigarettes. This is a sort of crossword puzzle, and you may guess what the article is. It ought not to be very hard to guess what it is, and at least I can tell my Californian friend, if he complains, that I did not mention the name of his article. I can tell him that I was like the boy that sold the man a horse, and the man came back to him and said that the horse had spavins on three legs. The boy said, "Well, I knew that, but I was always of the opinion that that sort of thing should be kept a secret." So I am keeping the name of this article a secret. If we had a tariff on that article which was enough to adjust the difference between the cost of production here and that at which it could be produced outside of this country, the tariff would be so much outside any cost of production as to work a very great hardship on the persons suffering with the disease for which it has become an increasingly characteristic remedy and work a considerable hardship upon that great and apparently increasing body of Americans who use cigarettes, a curious combination, to be sure.

I will have to tell you the name of this article - it is menthol. You have all heard of mentholated cigarettes, and you have heard of hay fever. We cannot have a duty on menthol as high as the difference in cost of production here and abroad without working a very great hardship to these two great groups in this country. Therefore we simply do not do it.

So when I started in to say that that program that seemsvery simple, to make the tariff equal to the difference in cost of production here and abroad - it sounds beautiful, but it is not really what you want.

There are other serious obstacles to getting what they call a flexible tariff, because it is not changing all the time. What is a flexible tariff if it remains permanent all the time?

Take our friend wheat. The tariff on wheat was 30 cents a bushel when the Tariff Commission took hold of it and took the duty up to 42 cents. That was supposed to be the difference in cost of production between the United States and Canada. That change was made in the summer of 1924, the presidential election year 1924. You know Judge Shute says in his biography of a bad boy that there is something very queer that so many more boys are licked in school on Monday than on any other day of the week. It is also queer how much more active the Tariff Commission has been in years that are divisible by four than in other years.

At any rate, in 1924, it appeared to my wise and good predecessors that 30 cents a bushel did not measure the difference in cost of production between American and Canadian wheat, with the result that the tariff must be changed to 42 ¢. That is what it is now. It has remained undisturbed for 12 years. The fact that the tariff has remained undisturbed for 12 years militates against the theory that it is extremely flexible. Do you know anything else that has remained just exactly the same for 12 years? If you have been paying exactly the same price for any commodity for 12 years, you don't call that very

flexible, do you? Of course, during that time, wheat was sold at all kinds of prices. I believe in the extreme depression, there was a time when wheat sold for 25¢ a bushel, in which case if Canada wanted to bring wheat into this country, she would not only have had to present this wheat to us, but would have had to say, "Here's 17¢ a bushel to help pay the tariff on it."

Now there's a great deal of difficulty in finding out what the difference in cost of production is between one country and another. It is changing all the time. It may change every six months, every three months, every three days. The "chief competing country", which is the phrasing of the statute, keeps changing all the time.

I have some people coming in to see me in a few days who want to prevent the importation of articles from Country A, let us say. Under our statute, Country B is the chief competing country. Those who do not want to see articles come in from Country A want to have it written into the statute prohibiting the importation from Country A. But if we are to consider the "chief competing country", we must regard it as Country B, because Country B is the chief competing country.

The difficulty in finding the cost of production is enormously serious. In the Harvard School of Business, they have a saying that "accounting is a tool of management." If you run a hotel or a haberdashery or anything else, your system of accounting is more or less a tool of management. On the theory that we are to go out and find the cost of producing these articles here and the cost abroad, that might in a way seem simple, but there are so many different trade practices.

Take maple sugar. A friend of mine who owns a large $60,000 farm in northern Vermont told me that maple sugar can be made a paying crop only upon this theory; you must start in with the theory that your horses and oxen have nothing else to do at that period of the year, and therefore it doesn't cost you anything to have them pull around maple sap, and second, that your hired men then have nothing to do and they will not cost you anything, and that the winter winds have blown down a great many limbs from the trees and therefore your wood didn't cost you anything, and that if your woods needed thinning out, it does not cost you anything to boil the maple sugar. If you start out with the theory that your farmers and your helpers and your fuel cost you nothing, you can make a successful maple sugar business, but otherwise you cannot.

But when our Government experts go out there to find out the cost of producing maple sugar, do they think so? They do not. They would ask the farmers "How many hours did your hired men work", and "How much do these horses cost you?", and how much wood is worth a cord, and you would get a picture of the cost of producing maple sugar which would be altogether different from the practical cost that the man who is producing it has in mind.

One saving grace is that Canada is our chief competing country. The probabilities are that the maple sugar people are working on that basis up there.

You take caseine. I didn't know what caseine was. I had never heard of it. I think the derivation of the word suggests something to do with cheese. I hope I know just enough about it to talk to you on it, but perhaps I am not exaggerating your intelligence when I say that.

What is caseine? There are 99 different business motives for keeping cows, and for being in the dairy business. You may keep cows to

raise them for milk, or to raise them for beef, or butter or cheese or the uncatalogued variety of things. There are groups in the dairy business who sell milk and who raise beef and various things. Take, for instance, skim milk. Now there are 19 different uses for skim milk. You can give it to young chickens, to young pigs, to young cattle, or you can throw it into the sewers; you can sell it to the bake shops, as they do in Boston, or you can do 40 different things with skim milk, and one of those 40 things is to make caseine out of it.

Suppose you are sent to Minnesota with a group of Government experts and some Remington-Rand adding machines and comptometers for the purpose of finding out what it costs to produce caseine there, and suppose the good farmer tells you this story: That he ordinarily feeds his skim milk to his young cattle, but that Saturday afternoon his boy Bill was going down to the village 10 miles away with a Ford and that, as the skim milk was accumulating a little too much, he said to the boy, "As long as you're going down that way, maybe you could take with you a barrel of skim milk and sell it to the caseine factory." How much did it cost that farmer to produce that caseine under those circumstances?

You can well see that you can start in a way back with the first cow that Adam named. It becomes more difficult when you send a delegation to the Argentine Republic, with translators, to find out what casine production costs there, because that is one of our chief, in fact our principal, competing country.

So I become somewhat skeptical of the cost-of-production theory. I don't think that is exactly what you want. I think tariffs are matters of public policy. If I were to revise the law, I should have the Tariff Commission make a general economic study and go into all sorts of facts and figures and make recommendations based upon what might be called a general economic survey, on which a great deal of information could be obtained.

Of course, there are several statistical factors that lend themselves to this kind of study very readily. One is the price. What are they selling caseine at in Minneapolis, and what are they selling it for at Buenos Aires? That is probably collected every day in the year and given to the commercial papers. The bid price is an extremely important factor regardless of what it costs anybody to produce. The same is true of the situation in Chicago.

If I was asked to see what the duty should be on maple syrup, I would ask "What are they selling it at, or quoting it at in Minneapolis, under competitive conditions, or in St. Johnsbury, Vermont." Those two prices would throw a great deal of light on the subject. Another factor that would throw a great deal of light is the movement of traffic. If there is a lot of maple sugar coming in from one country to another, is it an increasing amount or a lessening amount.

They are of course by-products of a cost-of-production investigation. The next stage of the history of this case, we see operated in 1931, and on the cost of production theory.

There are several natural anomalies in the case. One is - is this scientific in the customers' way of saying scientific terms. If so, why does the President have the power to handle it? If you had a scientific Weather Bureau and they told you it was eighty-two degrees in Washington and sixty-two in Buenos Aires today, those facts would stand because it would not be incumbent upon the President or any other officer to

reject those figures. The very fact that the law gives the President the final say, I don't object to; but it does militate against trade that there is such a thing as a scientific arrangement of tariff rates.

Now we come to the Hull Program. In this Administration, two years ago this summer, under the leadership of Secretary of State Hull, there was put through a bill giving the President, the executive officers, the Secretary of State, headed by the Tariff Commissioners, and others, power to make treaties with other countries for a lessening of duties upon both sides. One great argument for that which is very objective is this: If we were to reduce the tariff on casein, let us say, with the Argentine Republic before the Hull Program, we would be getting nothing for it. We would be doing it because we wanted to help the consumers a little. Under the new tariff program, if we make any reduction in maple sugar or anything else, we actually in practice get some benefit in the form of a trade opening from the other fellow.

That is wherein I like it very much better, and I am a Republican. Since this is a non-partisan gathering, I want to make my position clear. I am one of the Republican members of the bi-partisan tariff commission, and at the same time it seems to me that the Hull Program, the Hull Plan, of trade with other nations is very much better than the Section 336, which preceded it, growing out of the cost of production.

Now there are several things that are very much in the public mind in the way of criticism of the Hull Plan. Of course, you understand the reciprocity idea is a very old one, the idea of making a trade with other nations. I remember, and the grandfathers of the young ladies here would remember, that in the McKinley Administration an Iowan was sent over to Europe to negotiate some reciprocity treaties. The President had a right to do this under the tariff bill then prevailing. He negotiated fourteen treaties and brought them back here. The President submitted thirteen to the Senate. They were rejected. He did not submit the fourteenth. Having seen thirteen rejected, he did not go any farther with the fourteenth.

That was in the days of the two-thirds requirement. They were submitted for the two-thirds requirement, and you could not get a two-third majority in the Senate for any sort of let-down in the tariff. The people affected by the legislation wrote to the other fellows and said, "Hold on, let us all stand together." The result was that thirteen of those treaties were rejected, and nothing could be done. Nothing worthy can be done in reciprocity through the two-thirds majority in the Senate.

Experience points in the other direction. The law as it now stands gives the President, acting through the Secretary of State and the various bureaus that make the trade with the other country, the power to sign with the other country an agreement operative for a period of three years.

Now there are phases of that that are under a great deal of criticism that I should like to speak of. Many people criticize the most favored nation clause. This is a very common observation: "I believe in the things that the Hull people are doing, but I don't like the most-favored nation clause. I don't think we ought to give the thing to a third country." We make a trade with Canada, let us say, and all the extensions or lower taxes that we give Canada apply to every other country that we do business with. And people say we are being bribed, and we ought not to give them to the other fellow.

But the other fellow gives the most favored nation treatment to us, and unless he gives us the same treatment, we do not give it to him.

It is just as long as it is broad. We might make a trade with Canada, and three months after our trade was over, Canada might make a trade with someone else lowering the tariff. The subsequent trade has lowered the Canadian tariff, and we now enjoy that advantage. We get something more than we have. I think the most-favored-nation plan is a non-partisan affair.

The man who did the most to make it American policy was Charles Evans Hughes, Republican Secretary of State in the Harding Administration, and now in the Supreme Court. He was a great believer that it was American policy to have the most-favored-nation treatment for everybody. We are a single-column tariff country. We have a schedule of tariffs that apply theoretically practically to everybody. We started out with that. Various other countries have two or three different columns.

Canada has had three different columns - one for the British Empire, one for special treaty people, and one for the outside world. It is very much to the advantage of a single column tariff country treating everybody alike, for the other country treats it as well as it does anybody.

Treating everybody alike - I always remember pertaining to that what a woman missionary in a province of India told me once on board ship. I said to her, "When one of your heretics becomes a Christian just what does he do differently - what are the practical relations of his life that are different?" She said, "I'll tell you. We had a little shopkeeper, a little fellow that kept a store, who was converted to Christianity at our mission. Before his conversion he used to sell his goods for the most that he could get for them. The minute that he became converted he went under the one-price system, treating everybody alike."

I said, "I'm glad that Christianity has such a favorable effect."

I think that that applies to nations. We get along better with the world in treating everybody alike, as long as they will treat us in the same way, as well as they treat anybody else. There are certain practical objections to doing anything else.

We have most-favored-nations treaties existing today for which the Administration is not responsible. In large part at least with thirty-three countries, many of them could not be withdrawn in less than a year, probably more than that. In other words, if we wanted to go over to the individual bartering treaty, we would have to ease out at least thirty-three nations that we have already signed in the bond to do that. The foreign entanglements and friction that would run in on us would be very great.

Then there is another idea that you hear people constantly advocating that I want to say a word about. There are a few countries in the world from which we buy more than we sell. The greatest example is Brazil - the reason for it is coffee. We are tremendous consumers of coffee. In consequence of that we buy a great deal more every year than we sell Brazil. People blow into the picture, those who say that we ought to have a treaty with Brazil that she must buy of us as much as we buy of her. The other countries must buy just as much of us as we buy of them. In Brazil, there would be so many more dollars that Brazil could buy of us in goods. There is a yes and no to that.

The trouble with that idea is so many people want to practice it. In nine cases out of ten it works directly against us. What is holding up our Spanish negotiations is the belief that we sell Spain a great deal more than we buy of Spain. Spain wants us to do just what people think we ought to do with Brazil.

In other words, that idea has a great deal of currency throughout the world, and it is not to our interest to encourage that idea. For if we should do so with Brazil, the other fellow would turn right around and say, "Yes, you make Brazil buy as much of you. Why not turn around and do the same with us?"

In the case of Great Britain that would be particularly perilous. I don't think we ought to proceed on that way. The relation of all these things to the peace problem, to the problem of getting along well with the children of men, is exceedingly important. If you ever see a person who is in a state of anger and indignation against some other country's commodities coming in, that same person is just getting ready to declare war on that country.

The Governor of Massachusetts, who has just announced his candidacy for the Senate, made a speech the other night in the New York Town Hall. He was talking chiefly about Japan, the affair of imports from Japan. They asked him what about selling in our country to Japan, who is our largest consumer of cotton. Japan buys more cotton than any other country in the world. They asked Governor Curley what he would do with that market, and he said he favored taking the two million bales of cotton and dumping then in the ocean, of course at Government expense. That is the basis of all reform enterprise, of dumping it in the ocean rather than have the goods that it would buy brought into the country from Japan. That is easy to be said - it has the benefit of simplicity.

Personally, I do not believe in it. I believe in more liberal trade relations. I rejoice in the great message to mankind of Adam Smith, and its influence upon the American people and our universities. I have always had a great deal of sympathy with Henry George. When he spoke in Boston fifty years ago, somebody shouted out from the audience, "Do you believe in Adam?" He replied, "Yes, in Adam Smith." Now I have a great deal of sympathy with that conclusion.

He wrote volumes of books. The one that we refer to particularly was written in 1776, the year of our Declaration of Independence. Perhaps nobody can name the other books. One of the books, known as the Wealth of Nations, pointed to a new theory in the world. The world had been oppressed with the mercantile theory, and he presented the view that the fellow who sold you something was not your enemy, that you might make a better trade from having exchanged something with him. There was an advantage on both sides. He reported those theories in this book, The Wealth of Nations, in 1776.

It was brought to the United States in 1783, the year of the end of the Revolutionary War. It influenced the minds of the men who drew up our Federal Constitution. The people there in the old colonies were not great traders with one another. At that time New Jersey refused to light a lighthouse because it would be a benefit for New York commerce rather than its own. There were state barriers. These men who made the Federal Constitution, greatly influenced by the great message to mankind of Adam Smith, wrote into it that trade should be free and uninterrupted from one end of this country to the other.

And it has grown until today we have a trade area greater than the whole world of Adam Smith. We have in our own country most of the problems that the world has. Take my own state of Massachusetts. A hundred years ago we were the eighth in population and now we are the ninth. We are still on the map, and yet during that time we have seen industry after industry leave us. Iron works were very familiar; no one now

sees iron works. We see our boot and shoe industry scattered and yet we are still going on due to the diversity of trade.

Think what this diversity has meant to our great mass production. We used to make buggies in Massachusetts. We had a buggy plant transferred into an automobile factory in Concord, New Hampshire, making coaches, but I am glad that our set-up was such that it was possible that in the little state of New Hampshire, four hundred people could make automobiles for somebody else. I am glad for the great diversity of mass production, the mass selling, throughout the continent, which the great theories of Adam Smith made possible.

And that is what I believe is fundamental in this whole thing, and we want to look at these things in as large and generous and broad a sense as possible. I want to tell you people a story - I believe it is the privilege of an aged man to draw from the stories of old age.

They are getting up a three hundredth anniversary of the founding of Harvard College next fall to celebrate. I was alive when they had the two hundred and fiftieth anniversary, and I always remember the torchlight procession in those days. The different classes were telling the things that they had to boast of. The freshman had just gotten there; they had just unpacked their trunks. The result was that they carried in the procession the greatest thing that was said on that occasion. The freshmen headed up the long line with these words: This college has been waiting two hundred and fifty years for us.

Well, that was about the time I graduated. Shortly afterward, I remember we had breakfast the day that we graduated at the home of the President of the college. He was a famous man in his day. We went to his house that morning for what they called the breakfast. Food was not his long shot. I was disappointed in it at the time. I hope my estimate of the value of appetizing food has not risen, but at any rate I did not think much of his food. But I thought that what he told us was of the bread of eternal life.

He said that we would find ourselves in different religious groups, in different professional groups, in different locations, that various means of scattering would go on from that time, but the one thing that we need remember above any other was that we could in whatever group we belonged, belong to the liberal and progressive element.

That, in my handling of the tariff question, I have tried in my extremely humble way to keep in mind, and I pass it on to you.

DISCUSSION

Question - Would you care to mention the effect which the devaluation of the American dollar or the depreciation of foreign currencies has had upon the tariff making function?

Answer - I think that is greatly exaggerated. I don't think that the change of your yardstick of measurement has very much in the long run to do with it.

I go back to what the Minister of the Netherlands said when someone said to him that could not they be very much more prosperous if they devaluated their currency. And he said that such advantages as followed from that were either temporary or illusory. Those that were not illusory were temporary, and those which were not temporary were illusory.

I think that is a pretty correct statement of the story. When I was

first in France in 1903, the franc was worth nineteen cents. The last time I was there, which was five years ago, it was worth four cents. It goes without saying that I could not get for two francs the same meal five years ago that I could for two francs in 1903. In other words, business had adjusted itself to its changing yardstick.

Gold used to be worth twenty dollars an ounce. It is now worth thirty-five dollars an ounce. We have come to a fifty-nine cent dollar. I think the world adjusts itself to those things sooner or later.

Take the case of cotton. Cotton was six cents a pound under the old dollar, and it is now worth eleven cents a pound. We can see that it has pretty well adjusted itself. About the same amount of wool on the scales will buy a bale of cotton today that it would in 1932.

The dollar, the franc, the unit, is in constant adjustment. I don't myself think that these currency devaluations are a great factor in international trade. I think it is very much exaggerated.

Question - Do you think that we are moving forward toward a more liberal philosophy and free trade, such as practiced after the time of Adam Smith and up to the middle of the last century, or do you think we are going on dealing with these various trade barriers? What will be the future movement?

Answer - My dear sir, the Weather Bureau is in the Agricultural Department, and they do the most successful business in predicting of anybody that I know. I don't know what is going to happen in the world.

There has been every since the World War a tremendous rush toward economic nationalism. One of the greatest things of all was the dropping of England away from its historic low tariff policy. What is going to happen - the outcome - I don't know.

There is a man up our way who wrote a lot of books on the tariff. He was a cousin of James G. Blaine. He was a very scholarly man, and in the last years of his life he took the view that we ought to be a low tariff country, that all the tendencies with us were running toward a low tariff, that we would have our largest advantage in the world as a low tariff country. I have not seen his views shared by a great many people.

The tariff is so largely a question of what the individuals wants to do for himself. I read an interesting editorial in the New York Herald Tribune, a Republican paper, solely in praise of the lowering of the tariff through the French compact. Said this article - it would bring in French wines, that we needed better and cheaper wines, and they were strongly in favor of it. It seemed to be a reasonable inference that the man who wrote that editorial liked to sip good wine with his dinner and did not have an extensive grape orchard in his apartment.

In other words, people are out for the thing, the way the quality strikes them. I am sorry to have to confess my belief that there is a great deal of selfishness in the world. I think we people here are the only ones absolutely free from it.

Question - I was very much impressed by your discussion of public policy, as being the basis for a tariff, particularly in view of the fact that something more than a third of all the senators were impelled by various reasons to object to lowering the tariffs. I am wondering just what the current theory on the tariff is?

Answer - I think it is one of public national policy. What do we want to do about it is the

great question. There are some things here in some industries that we want to keep in this country as a national policy, as a matter of national pride, and things of that sort. You take Los Angeles County, California. Somebody tells me that if they raise oranges in the United States at a certain cost, in the next province in Mexico they could do so without the smudge pots and with lower priced labor. I say, "Never mind, we like the looks of these orange trees. We would like to raise them here." We will have to have a reasonable tariff here and get the orange industry here as we wanted to keep the beer industry. I think that anything that could be done within reason without too great a maladjustment of prices should be done here.

Question - I don't see the reason, though, for sticking us poor consumers for prices to cover items which could be much more satisfactorily and much more cheaply produced elsewhere.

Answer - That's an old free-trade argument, the argument of the consumer. I am glad you mentioned the consumer, because I so seldom hear from him. There is something to be said for that - that the consumer should be considered. But now these diatribes against Japanese goods that you hear on every hand - you can get up an indignation meeting in pretty nearly every town in the United States against something that is coming in from Japan, yet each thing is usually a great bargain to the ordinary consumer. You get great bargains in toys and all kinds of small articles from the Japanese.

There is a certain amount of wholesome nationalism which should be upheld, too. We cannot throw everything down and leave no barriers as we do between the States in the American Union because we have so many obligations in which the different states participate. But we can be reasonable, and I think that is about all that could be hoped for. What do you think?

Question - I should think an economic survey might be made of the things that we can produce economically and make sufficient allowances for such things as are actually within the purview of national defense, and possibly set up a tariff on some of these things that come within the purview of national defense, or merely substitute. I think, particularly, this would relate to optical glasses, a very important item in war time. We have had a tariff for some years on optical glass. Mr. Eastman made millions of dollars, and you still get the best lenses from Germany.

Answer - There is something in your argument with which I am not in favor. The American people - no people in the world are ready to go entirely to the free trade program. Of course, Great Britain by means of it in recent years has had some success with it. But even Great Britain is giving a bounty on beet sugar, and all that. It is unlikely that any nation will go to an entirely free trade basis. The thing we want to keep from doing, if possible, is going to an entirely nationalistic basis. You take a lot of people in this country who are advocating complete national isolation by America keeping everything at home in America. If we can stop that or at least hold that tendency in check by handling it reasonably, I think that is about all we ought to do.

The tariff question is so extremely complex, at least it seems that way to the average person - we believe in having an industry protected sufficiently to build up that industry in the country. Well and good, if all the facts are known, but so many times the tariff is so covered up with details that nobody knows exactly who gets the benefit of it.

Question - Do you think we are approaching a more understandable viewpoint of it where the people can get the benefit of the tariff and the general principle of it rather than special groups, and that the people understand better what is going on?

Answer - I don't know. It is true, as you state, that the tariffs are very much complicated. The one person's costs are very much increased. There may be a man getting what you would regard as an exorbitant tariff, but when you consider what he has to pay on the ingredients of his commodity, he may not be getting an excessive one. In other words, it's all one thing building into another so that it is a little hard to know what these things are, how they turn out. It is a question of very great complexity, and I admire your courage in this body, on a hot day, in giving consideration to it, and particularly in going into conference on it. I had supposed that when I was through everybody would be dead.

SOCIAL SECURITY

By
Dr. Ernest S. Griffith,
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The American University is a joint sponsor for this series of lectures, and consequently, I am particularly gratified at being able to meet with you.

The background of social security stretches a long way. There was a time when misfortune was supposed to connote sin of some sort or other; but as our industrial order became increasingly intricate, more and more it was borne home upon us that misfortune was essentially irrational; that there was relatively little connection between a man's effort and what happened to him in the way of unemployment and illness, and need in his old age. Perhaps old age, which brought poverty, might have been the result of good living, whereas he might have died at middle age if he had sinned sufficiently frequently!

In the second place, apart from this irrationality of misfortune, I think it has been borne home on us in the last four or five years that thrift, which was for years the American substitute for the social insurance systems of European nations, was probably impracticable as a solution. You probably remember that cartoon that won the prize in 1933 - of the man sitting on the park bench in rags, unemployed, his head in his hand, and by him a little squirrel who said to the man, "Why didn't you save for a rainy day?" His answer was, "I did", and in back of him were the closed doors of a bank. That may have been an extreme statement, yet much more to the point than the more occasional failure of investment in savings is the fact which has been borne home upon us that in this nation, allegedly with the highest standard of living in the world, probably the majority of the families are actually earning incomes which are lower than those which are supposed to be necessary to maintain a decent standard of living. In other words, the saving wage was always largely fictitious for the masses; and when we add the uncertainty of investments, the great fluctuations in the prices of agricultural products, which, instead of rewarding thrift, frequently penalized it in the sense of bringing less income for more work; the uncertain distribution of illness and old age, we suddenly realized that this which we had called a saving wage, this responsibility for misfortune which we had insisted was an individual responsibility, really ruled only in a period in which there was for practical purposes a frontier, a place to which men could go if they were out of work,

Then we recognized that there is a third factor in the background of the social security legislation,- that these misfortunes, though they are individually irrational, are to a very considerable extent the product of the kind of economic order which as a society we are pleased to retain, and that if the economic order itself failed to provide a saving wage and a certainty of employment, then those who thrived by the economic order in the period in which they did thrive should be prepared through a method of insurance or otherwise to safeguard those who are unfortunate, - not as a charity, but as a right.

Finally, and this also is a product of the depression, we have adopted for better or worse the point of view that the financial

responsibility for distress can no longer, should no longer, be borne by local units. There are two reasons that primarily have brought us to that conclusion. True, we drifted into it during the depression. We drifted into it because the States and the counties and the towns could not financially face the burden involved. But deeper than this temporary aspect of the depression were two factors that will remain when the depression is over. The first of these is the regional variation in wealth whereby certain areas find themselves with a per capita wealth double that of other areas. The second factor is that many of the more productive sources of revenue, sources such as income tax, the inheritance tax, etc., upon which Government must rely to a great extent, are scarcely suitable even for the wealthy States in amounts sufficiently high to be productive and to make possible the social security system - quite apart from the fact that they are scarcely applicable at all to States such as those in the deep South and to many of the agricultural States of the Middlewest during periods in which prices are not sufficient to provide a substantial cash return on the basic crops.

In this background, then, of the irrationality of misfortune and the impracticability of thrift as a substitute in large sections of our country, in the dawning realization that much of misfortune must be laid at the door of society, and finally in the inadequacy of the local unit as a financing medium, we find the genesis of the Federal efforts in the direction of social security.

The Social Security Act was passed at the height of the depression, in a situation in which relatively few States had experience even in old-age pensions, and but one State had even so far as stood at the threshhold of experience in unemployment compensation. I have distributed, or will distribute at the end of the lecture, a leaflet which will give you the main points of the Social Security Act in summary form. I wish to devote, therefore, but a short time in summary, and then to proceed to some of the more critical problems created by the Social Security Act.

In the first place, the Act contemplates an expansion of public assistance beyond that which at present rules, and on a much more permanent basis. The largest expansion is to take place in the field of old-age assistance, but there are substantial grants for dependent children, for the blind, for vocational rehabilitation and for the extension of preventive medicine.

The second main part of the Act has to do not with old-age assistance (that is, not with Federal grants to the States to aid those in misfortune) but with a great system of old-age annuities on a contributory basis and with variations in the scale of benefit.

The third major section of the Act is what is called in the Act "Unemployment Compensation", more familiarly known probably to you and me as unemployment insurance. There is no time to take up in detail the various special aspects of public assistance included in the Act. I shall content myself merely with a brief analysis of the provisions for old-age assistance.

In the first place, in its simplest form, this particular provision provides that the Federal Government shall match such pensions as the States may decide to offer up to $15 a month per person. A State is really allowed a considerable amount of discretion. In the first place, it may prescribe the size of the pension. There is nothing to prevent the State going

above the $30 a month. There is nothing to prevent the State giving no old-age pension. There is nothing to prevent a State from setting the pension at the exceedingly modest figure of $10 per month. That is perhaps not the whole truth, because you recognize as well as I do that the inducement of a grant-in-aid under the polite conviction that the rest of the nation is paying for the bill is likely to cause the States to stake out their claims to the maximum amount obtainable from the Federal Government, and such has already been the tendency.

In the second place, a State may prescribe the classifications of the aged to receive the pensions. For example, it may set the age at 65 or 70. The Federal Government will not aid under 65. A State may impose a means test. It may require certain conditions of responsibility. In other words, the persons to be benefitted remain within the province of the State. The only stipulation that the Federal Government makes in this particular aspect is to insist that whatever provisions are made must be uniform in all parts of the State.

In the third place, the State scheme for old-age pensions must be approved by the Federal Board in order to obtain a grant. The State itself must make a contribution. It is this particular problem which, as I understand it, is causing trouble in Kansas, where, - I think I am correct in this - the State constitution prohibits the State from making such contributions to public assistance. The State Public Welfare authorities must make regular reports, and, as I said, the grants must be uniform in all parts, and reach all parts of the State, in order to obtain the grants.

The second main portion of the Act having to do with the contributory old-age pensions is intended eventually to supersede old-age assistance for large categories of the population. As at present drafted, it is probable that it will eventually include approximately 50 percent of the aged. In this case, payment is a right and no means test is imposed, because the individual himself will have made his contributions during his working years. It is essentially insurance, but not with uniform benefits, given the same contribution as most insurance schemes, but with a certain amount of weighting. The details are a little complex, but the actual fact is that those in the higher income brackets will receive rather less than they contribute, and those in the lower wage brackets rather more,- not to an excessive degree, but within a limited extent. Also, it is so arranged that for a number of years those who come into the scheme past the age of 45 or 50 will actually draw out of it much more than they have put in, and that will be to some extent at the expense of the younger contributors. The scheme is in itself to come into operation gradually. Half of the payment into the benefit fund comes from the employer and half from the employee, in the form of a pay roll tax which by 1949 reaches 6 percent, 3 percent nominally from each of the two groups. This is then definitely a national scheme. The States have no participation in it, for two or three reasons: in the first place, mobility of labor is such as to make such participation unfair and difficult and secondly, certain areas, notably Southern California, are particularly attractive to the aged. If such a State had to carry its own aged, it would be more difficult and certainly less fair.

There is a real problem in the reserves which will be accumulated if the Act remains in its present form. I do not personally anticipate

very much difficulty that way; I think it is calculated that after some 20 or 30 years, the accumulated reserves will be greater than the total of the national debt at the present moment, and will even go on beyond this sum and provide the Treasury with something like a $10,000,000,000 surplus. The fact is that, long before this happens, this particular clause in the Act will probably be modified, because there will be the inevitable temptation as soon as reserves pile up in any such fashion for the various pressure groups involved in the insurance scheme or otherwise to say that such money ought to be distributed. To date, somewhere in the neighborhood of 25 States have qualified under the old-age assistance clause of the Act. Within approximately a year, the amount paid for old-age pensions has jumped from $24,000,000 to over $200,000,000. That gives one some idea of the initial effect of the Social Security Act. It is expected that this $200,000,000 will eventually reach billions annually.

The third main feature of the Act, unemployment compensation, calls for rather more consideration. In the first place, it is much more difficult to generalize, because the Federal Government, with but relatively few, and those minor, provisions, leaves to the States freedom to draft their own schemes. The only requirements have to do with reporting, with making the Federal Treasury the custodian of the funds, with relationship with the employment exchanges so that the payments can be made through those exchanges unless an exception is granted. It is also provided that there shall be no undermining of labor conditions. For example, no one shall be deprived of benefit because he is on a strike, and nobody shall be deprived of benefit because he is unwilling to take a job below the prevailing wage in his occupation. Those are two clauses that may prove somewhat difficult to administer and that undoubtedly will give rise to a considerable body of administrative law. It is also provided that the employees must wait until contributions have come in for two years before benefits may begin to be received. These provisions have relatively little to do with the essential elements of an employment insurance itself, and we may, therefore, look for a considerable amount of experiment out of which will probably emerge schemes suited for States with particular types of industry, with perhaps eventually some convergence upon a type for the nation as a whole. The only levers retained by the Federal Government, albeit powerful ones, are first, a small optional grant towards the expenses of the administration of the State acts, and second, and this is the key to the Federal Government's part in it, the remission up to 90 percent of the receipts of the pay roll taxes in States participating. The particular device used thus is again the pay roll tax. Another 3 percent eventually - this year it is 1 percent - is to be imposed in the form of a pay roll tax upon all employers in the main categories of manufacturers, merchants, etc., make a total in all of 9 percent. This you recognize is a pretty heavy tax. The Federal Government collects this tax substantially uniformly throughout the nation, but, and here's the important provision, if a State, we will say New York, has a scheme of unemployment insurance, the employer may deduct for his contribution toward that scheme up to 90 percent of what he otherwise would have paid to the Federal Government. Thus the argument now being used throughout the United

States in order to induce the passage of unemployment compensation acts in the several States is that the State's employers are going to pay anyway, and might just as well have the money stay within the State.

Eight or nine States have thus far adopted unemployment compensation schemes, but I think we may expect this number to grow considerably as the pay roll tax grows. This flexibility of States' schemes has already revealed a large number of issues, and it is the solution of these issues that in a sense constitutes the essence of the goodness or badness of a scheme of unemployment insurance.

The first has to do with the unit to be insured. Probably the most important single decision to be made in any State act is this. There are three general types. Wisconsin, in a sense, insures each employer separately, with a somewhat elaborate provision by which the employer builds up his own reserves and when his reserves reach a certain point, he may stop paying in to them. Until such time as they again fall below a certain reserve through having paid out to his employees who were unemployed, he does not have to pay into the reserves. That is carrying to an extreme, if you will, the system or the idea that if the penalty rests directly upon the individual employer, he will make a stronger effort to stabilize his employment, he will have a stake in the elimination of unemployment. At the other extreme is New York State, for example, which has a pool of all the payments from all of the employers, and out of that common pool the benefits are paid to the workers as they are out of work. Individual responsibility of the employer is very much lessened. In between the two is the Ohio plan, which has the general pool for the funds, but provides what is known as a merit rating, by which an employer whose employees have been with him steadily and an employer who has made provision for stretching out work and stabilizing his employment, etc., after a certain length of time receives a recognition of aid in the amount that he is required to pay into the fund. The issue is very important as weighting industry in the direction of stabilizing industry.

On the one hand, the Wisconsin scheme has been attacked on the ground that it does not provide security for the employee; that even a good employer can become insolvent. On the other hand, the New York plan is attacked strongly on the ground that it provides little or no incentive to the employer to stabilize his work force. There is a provision in the New York Act which points in the direction of ultimately becoming the equivalent of a merit rating. Yet in general this type of unemployment insurance act does not bring home to the employer the responsibility of the industry itself to put its house in order so far as it is possible to do so. The Ohio plan on the whole attempts to meet both of these criticisms.

There is also the issue of the waiting period. Almost without exception, unemployment compensation schemes require a certain period, perhaps two or three weeks, for the employee to wait before he can draw insurance. How long should he wait; upon what should it depend?

Still another issue has to do with the groups to be insured. Domestic service, agricultural labor, are exempted or excepted in all the schemes thus far, and yet to some extent, at least, those

groups provide examples of casual labor at its worst.

There is a whole set of issues wrapped up with the question of the extent of the insurance itself, - the amount of payment, the duration of the benefits, etc. This does not mean that if the payment is limited to 10 weeks the person will be allowed to starve at the end of 10 weeks. It does not mean that if the payment is too small to take care of a family of 10 - there are still such - that the children shall be allowed to starve. The issue here is more of a question of how much of the provision of assistance shall rest upon the insurance part of social security and how much upon the local relief for those portions which are not yet provided for adequately in the Federal Act. There is, of course, a real issue tied up in this as to the proportion the benefit shall be of the prevailing wage or the preceding wage. Most nations have given a flat sum regardless of the wage previously received. On the other hand, most of the State schemes in our country have attempted to relate the size of the benefit to some extent to the amount of the wage.

That is a very important question, because it goes to the heart of a characteristically American way of meeting a depression. This has to do with the issue of part-time employment. The net effect of unemployment insurance in England was virtually to obliterate such part-time employment. In all probability in most of the schemes thus far adopted in our States, much the same thing will result. This strikes at the root of a major part of our way of meeting the depression. All through 1930 to the present day, thousands of employers, particularly in manufacturing, have met the situation through working two or three days a week without laying off employees. We are creating a very serious situation when we introduce into this type of a situation a legislative provision which places a penalty on that kind of thing. In other words, the probabilities are that in most of the States, in most of the Acts thus far drafted, that this particular method of distributing work will be at an end except in so far as the gain to the employer of maintaining his working force intact even for two days a week transcends the economies that would be his through being able to shut down an entire unit or through the savings that might accrue from laying off completely the least efficient or most troublesome.

The point is this, really, that in drafting an unemployment insurance act having to do with the conventions that have grown up in American industry, we may find ourselves forcing the employer to lay off the less efficient and thereby increasing the number of national unemployed, rather than in doing what we have always supposed to be the more humane thing which was to spread what work he had among all his employees.

May I digress for just a few minutes to give you certain illustrations from British experience which will point out the kind of thing I have in mind when I stress the importance of having your legislation weighted in the direction of practices which you consider desirable.

For a considerable time the British insisted that anyone who was out of work as a condition of drawing benefits beyond a certain period must indicate that he is genuinely seeking employment. And I remember sitting on the Board to adjudicate that kind of

thing, and the number of lists that were brought in by the unemployed of employers that were called on during the week. We used to insist on that particular practice. Employers were bothered and there was nothing in particular we found out, though there may have been some value in wearing out shoe leather in that fashion.

But finally England dropped that. For one thing there was a lot of cheating involved. But quite apart from this it was so futile because there were not the jobs, and it also complicated the important relationship which they had attempted to set up between the labor exchanges and unemployment insurance.

I am thinking also of certain things in connection with health insurance. We found, for example, the practice of a physician giving anyone who had been ill an extra week's vacation. The physician, in his anxiety to retain the personal relationship - a justifiable anxiety - succeeded in incorporating in the health insurance act a provision by which a man might choose his own physician. What happened? The number of days lost through illness doubled within a year. Now that may have two explanations. People may previously have gone to work who should not have gone. But it also had another explanation. I found that out in the first place when I saw some people who were out drawing health insurance playing basketball or soccer. And any physician that refused to grant that extra week found himself short of business. He was boycotted. You won't find that in any of the reports of the Ministry of Health. I am not even sure that the Ministry knows it!

I am thinking also in connection with unemployment insurance of another relationship that was set up. I am not sure how widespread this particular practice was, but there was a provision in the British act by which if a man lost a job through his own fault, through theft or throwing an ink bottle at the foreman or something of that kind, he was deprived of benefits for ten weeks. The employer had to fill out a form giving the reason for dismissal. For a while those reasons were honest, but after a while the number of reorganizations of staff that took place or the failure to need so many men were given as reasons with monotonous regularity. That seemed to me very interesting, and I looked into it a little further.

I found that what happened was that if an employer had stated any reason whatsoever that had to do with the employee's fault which resulted in the loss of benefits, particularly if that employer was in retail trade, the working people promptly imposed a virtual boycott against him. Apart from this there was the natural humanitarian attitude of the employer who realized that in any event he was probably penalizing not the man himself but the man's wife and children. So those two reasons resulted in this particular provision designed to bring pressure upon the negligent employee being negatived in practice.

Then I ran into another thing that one of the large employers was alleged to do. He would work his staff until they were tired out and then would discharge them in a body or in rotation, and take on another staff and then after eight weeks would reëngage the earlier one. What he was doing was running shifts at top speed and letting the unemployment insurance fund pay for the care of these employees. In the last analysis this could not be proved because he was too careful.

By and large the greatest in-

dictment that I would have of the British scheme (most of our schemes avoid this) is that it has made the nation content to remain with a surplus of unemployed. If our Social Security Acts result in that particular attitude prevailing in the United States, it would have been better by far if they had never been passed, in my opinion. It has been a sop in place of a permanent remedy for unemployment.

And so my general point is this: That it is very important at this stage that we shall have ample experimentation in the states. To that extent I approve of the form which the Act has taken. It is important that we shall decide what things are desirable and incorporate those. It is important furthermore that we shall not leave very much to discretion, because if these privileges are left to administrative discretion somehow or other they have ways of turning out other than the way they were intended.

There are certain over all problems, but I find I must hurry through them. Official estimates for the cost of the Act point, when it is in full operation, to three billion a year for the aged, divided between the old age benefits and the benefits from the insurance, and a billion for the unemployed - a total of four billion or more than the normal Federal budget.

This estimate sounds startling enough, but I think personally that it is invalid. In the first place, we can assume I think that approximately fifty percent of the aged will be insured. This is the Social Security Board's own figure. Also within twenty years the aged above 65 will make up approximately ten percent of the population. In addition to these about half of the remainder, and this is a very modest estimate, are likely to be under the old age assistance provision.

Instead of telescoping the calculations, I think it is much more likely that this particular clause will involve costs amounting to four and one-half billions a year. The calculations as regard unemployment compensation contain so many variables that it is exceedingly difficult to arrive at any estimate. It is enough to say this - that the experience of the other nations has been that no scale of benefits ever remains as low as it starts, no setting apart of certain classes of the population for these benefits ever resulted in these being ultimately the only ones to be included.

In other words there will be, if we run true to form, a stepping up of the average payments for old age and for unemployment under political pressure. There will be the further tendency under a combination of political and humanitarian pressure to include in the scheme the groups now omitted.

For how many unemployed should we provide and at what scale?

Is it unreasonable to suppose for example that $850 a year is ultimately a fair estimate of what we shall provide? If so, for how many?

The usual estimate of the permanent group of unemployed puts it at around six million. Let us call that not the permanent minimum but the average, and we arrive already at a figure of five billion instead of one. Now that is problematical I grant you. But I merely want to call attention to this fact that the estimate of a billion a year assumes a status quo which does not seem reasonable in the light of the political experience of other nations. And it assumes a much smaller group of unemployed than our experience recently has indicated.

In addition to the old age pensions and to the unemployment compensation there are the other miscellaneous grants for which we may put down approximately an expense figure of half a billion, making in all somewhere in the neighborhood of ten billion a year. I am not saying this is ten billion too much or a billion too much, but it is somewhere in those terms that we should consider the magnitude of the program upon which we have entered. I do not mean ten billion next year nor ten billion five years from now, but ten billion annually fifteen or twenty years from now is not at all unlikely.

A very serious question will arise, particularly in view of the fact that we have had no experience, as respects the incidence or the ultimate effects of the payroll tax of nine percent. What is it going to do to prices? It is a tax that will be regressive in the sense that it is bound to be passed on to consumers and is primarily concerned with consumers' goods. Ultimately that type of tax, that type of cost, has a way of being pyramided, at least under the normal conditions.

Furthermore, what of the political problem involved? In the first place there are the vested interests of the beneficiaries. You may say that the alternation of a conservative and a liberal government will be such as to result in a reduction of payments when the conservative government comes in, even though they may be stepped up under a spendthrift liberal government.

The experience of England would not indicate it. Every government that England has had since she entered upon the field of social insurance has increased the benefits under social insurance.

You are creating a body of beneficiaries ten times the number of the American Legion, twenty times the number of the American Legion as soon as the number of aged reach their peak.

There are other difficulties at the moment. Public assistance has in the past been in the province of the counties and the towns by and large throughout the country. And the little inspectors of the poor and the overseers of the poor and the county superintendents of public welfare and the town vestrymen and so on have consistently as offices been reserved to the uncles and aunts and brothers and sisters and henchmen of the ruling political machines.

I am told that the real inwardness of the recent deadlock in the New York State Legislature by which they refused a gift of twenty million dollars from the Federal Government, much of which loss must inevitably fall upon the localities was really caused by the fact that the assemblymen were so close to the county machines and town machines, that pressure came from those office holders, relatives of the officers, and so on, that saw their days numbered if they no longer had that patronage to give out.

There is no way of checking up on that kind of thing, but we may expect to have a great deal added to the noise and color of the argument and very little to its enlightenment by cries of "interference with localities", the throwing up of symbols of states' rights, etc. What these people really mean is that they want Aunt Mabel to continue as overseer of the poor. That is the kind of thing that happens.

Let us deal next with the constitutional problem. It seems to me that - I am speaking as a political scientist - that it is possible for the Supreme Court to decide

either way. They have created precedents which make it possible to take either side of almost every question, and some of them do just that. In the end the decision is more or less likely to be on one of two bases. One, whether they like the Act, and two, whether they think the country will stand it and still respect them if they overthrow it.

There are an amazing number of administrative problems. Twenty-five million people have to be card-indexed for old age benefits. The estimated number of employees national, state, and local, needed to administer the Social Security Act is from thirty to fifty thousand within three years. Of those from three to five thousand at least must be in a sense responsible, trained people, and you can't find that number. It is the finest field in government for anyone of ability and character to enter today who wants a career, and who is willing to train for it, from the standpoint of prospects of employment.

The variation in state systems is going to make considerable difficulty. It may bring part time labor to a stop and it may make difficulty in the transfer of labor from one state to another. Most serious of all administratively is the fact that the Act deliberately omitted any requirement that state and local officers be under the merit system. When the Federal offices are under the Civil Service, the state and local offices are likely to be the happy hunting ground of the spoilsman.

There is an administrative problem involved in seeing to it that employers can use the same payroll records for the old age insurance that they use for unemployment compensation. There is a problem of investment of reserve funds. There is a problem in the relations between the Federal and the State governments.

Let me conclude this part by saying that the danger, the real danger, that faces social security in the United States is an administrative danger, and not a danger of slogans. It is the same kind of danger and I am not drawing any parallel other than the administrative difficulties, it is the same kind of thing that killed prohibition in the first few years by the absence of a merit system; it is the same kind of thing that after six months to a year of it turned employers against the NRA. They were disgusted not with the objectives of NRA but with the quality of administration under it. So also with Social Security. If the state and local offices are badly administered (and one wonders how they can help but be badly administered in the political forces that rule in so many of our states), if the state and local offices are badly administered, there may easily arise out of that situation such a wave of disgust that the whole social security movement is set back for years.

There are many difficulties in the Act, such as those connected with the reserves, which can be remedied. If the Act weathers the constitutional obstacles and the administrative and political obstacles, it will undoubtedly be extended. I wonder if we regard this continuance as a desirable thing in any event. You know, in one sense it marks the passing of the American Dream, the dream of a nation in which each person has the opportunity by his own efforts to provide for his own living, his own career, his own future, and that of his dependents. We have closed the book on that version of the American Dream. Yet maybe the Act is itself a realization of the Dream.

Maybe it is a realization in the sense that America sees that it is now wealthy enough, it is now humane enough, to assure that in this day and age the standard of living of its people shall never fall below a certain minimum. None the less I feel myself that a large part of the Act is a second best, that we have approached the day in which we find ourselves in a position so to manage our economic order that unemployment is a thing of the past, that the irrational misfortunes are eliminated. They are irrational because we allow them to remain.

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DISCUSSION

Question - I think there is a provision in the Social Security Bill which says that a person can get up to $85 a month of our old age benefits, and on the other hand it states that it only goes up to $15 a month.

Answer - Don't confuse the two things. There are two provisions for old age, two clauses, two titles, in the Act. One has to do with the immediate relief of poverty and old age - that is the old age benefit, or old age assistance. Now that particular benefit is restricted to a Federal grant of $15 a person. The state may put another $15 to it, making a total of $30 a month, or the state may go as much beyond that as it wishes. There is a maximum of $30 which the Federal Government will share half and half. The presumption is that for that particular grant the person must demonstrate need.

Now the second and the more permanent proposal does not come into immediate operation on a scale sufficient to make much of a dent in the problem. That is the contributory scheme of old age insurance. That is national, and the national scheme limits the benefits to $85 a month, regardless of how much an individual may have contributed. That is the contributory scheme. The $85 a month does not have to do with the need of the individual, but with the amount that he has put into the fund.

So separate the two things. It is confusing, and this second scheme will eventually take over a large part of the first, but unless the classes included are increased, it will take over but half of it.

Question - I wonder whether any states require the persons to remain in the states and spend the money there?

Answer - Now let us be perfectly clear on this. If you mean old age pensions, the person loses that by going out of the state. That is merely paid to residents of the state. If you mean old age benefits, the scheme is national and the state has nothing to do with it. If you mean unemployment compensation, it varies between the states.

A person falls out of work - he is entitled to a benefit. But suppose he lives in New York, and he has some relatives in New Jersey. He can go into New Jersey because he thinks he has more of a chance to get a job. In that particular case I think he can continue to draw his unemployment benefit, but I am not sure. The change of residence as far as old age insurance is concerned does not affect the benefits.

Question - Considering these amounts for pensions and benefits, what attention will be given toward price levels over a period of twenty years?

Answer - None whatever in the original Act. That is the kind of

thing that should be taken care of by a future Act of Congress if it became seriously out of line. You see the Board and the provisions merely have the basis of a Congressional Act. They can be amended, and probably will be amended in almost every session.

Question - Can the amount of the pension be increased at any future time?

Answer - The majority of the American people seem to favor an old age pension of sixty dollars a month, according to the returns in "America Speaks". That gives some indication of where public opinion stands at the present moment. Yet $60 would be a good deal to begin with. I am neither advocating nor opposing it.

Question - Does the Act provide for any particular way of handling the funds that will be allowed or are they just left to the general discretion?

Answer - With the old age pensions, that is, the grants to the states, there are no funds to handle. With the insurance part there is a special bureau created in connection with the Treasury which acts as custodian of those reserves, the state and the federal, from the old age insurance and unemployment compensation payments.

The idea is that these shall be under the control of the same agency that has to do with the monetary and banking policy of the country so that they can be handled in conformity with the national policy as regards price levels, the sale or exchange of securities in the open market, and so on.

Question - Will you please explain that nine percent tax on payrolls?

Answer - It is a little difficult to explain except simply to say that the employer has to certify in a rather elaborate form what his payroll is. Now the employee finds deducted from his wages, at present one percent, eventually three percent from his wages, and that three percent plus the three percent tax for unemployment compensation (of which up to ninety percent is earmarked for state contributions), plus three percent for the old age pensions will be calculated presumably at the time of payment.

Now in the end, of course, how these payments will actually be divided between employer, employee and consumer, it is not possible to predict because that kind of thing has a way of entering into the general economic order. It may reduce wages. It may raise prices. It might possibly reduce wages without raising prices very much. It may raise prices the whole amount. It may raise them more, in which case the farmer would suffer pretty heavily.

This belongs to the field of incidence of taxation. The more you study this field, the more you recognize that unlike the immediate effect, the ultimate effect becomes impossible of ascertaining.

Question - What will be its effect on workmens' compensation insurance?

Answer - I think it is a tribute to it. I don't think it will have any special effect on it.

Question - Except that it adds another percentage on to the payroll?

Answer - We have to recognize that these costs of misfortunes are borne anyway.

They are borne by individuals in the form of paying out their savings or they are borne by the town or the city in the form of poor relief, or they are borne in some instances by employers that have provided their own pension scheme. The Eastman Kodak Company is conspicuous in that field.

Unless there is something in

the Act itself which tends in the direction of creating more unemployment and more old age if you wish, than otherwise would be created, there is no extra cost. It is merely the transfer from one group to the other. Of course you may be giving them relief at considerably higher rates than they were accustomed to having. Then it may mean that during unemployment they will remain more healthy. You are introducing a number of new factors.

It is like throwing a stone into the lake. Its ripples reach to the farthest shore. That is the kind of thing that happens when you introduce this new tax.

Question - What other nations beside England have social security acts?

Answer - We are the only great industrial nation without it - that is, we were. We are not without it now. The schemes of other nations vary in extent. Germany was the pioneer. Japan has a very moderate scheme.

Question - What nation has one of the best systems?

Answer - It is a matter of what your criterion of best is. If it is adequacy of benefit, you might say one nation. If your criterion is a scheme which fits the economic order in the direction of stabilizing employment, you might give another.

It is generally supposed that the English and the German are about the best. But the criterion is ordinarily adequacy and I am not sure that that is the correct criterion. I am personally rather more inclined to censure some of these indirect effects of the British scheme, such as causing the nation not to do anything about unemployment.

Unemployment insurance is not a remedy for unemployment. There is only one remedy for unemployment, and that is work. But on hearing some people, you would think that insurance was a remedy.

Question - How lare a number of persons are outside of the Act, like those employed on the farms?

Answer - The Social Security Board's estimate in connection with old age is about fifty percent that are outside. In connection with unemployment compensation, it is necessary to break that down state by state.

The fact is that only eight or nine states have qualified under the Act, and in those states for the most part it has not come into operation. Nobody is insured yet. However, these states happen to contain much more than their proportionate share of the industrial population.

Question - These old people who are now on the farms, are they entitled to a share in the old age pension?

Answer - You are right in the old age pensions, that is assistance, if the states so decide - that is a decision that the state must make.

Under the old age insurance scheme people on the farms are not eligible at the moment.

Question - Neither the farmer or the hired man?

Answer - That is primarily I think in the drafting of the Act. It seemed wise in the first place to stick to one group until we were well under way. For example, the agricultural group and the domestic servants have just within the last two years come up for serious discussion. This would involve an extension of the Act.

We have in one Act gone more rapidly than any other nation. We are biting off a bigger chunk at one time than ever has been done elsewhere. This is doubtful wisdom, even from the standpoint of the advocates of Social Security.

~~It~~ might have been better to have gone more slowly.

Question - You have spoken of the German system, particularly of the old age pension. Is it not true that it was pretty well hit by the inflation?

Answer - The tendency in Germany under the Third Reich has been to substitute labor camps and "armies". That is a switch from the old unemployment insurance. They are very sensible about this - within limits. That is, why should a person be paid for remaining idle?

Then there is a fiction in any event involved in building up reserves. Just how should reserves be built up? What is gained by it? Why should not the Government merely advance the money, borrow if they need it? And so on.

The money has to come from the same place. Why go into all these elaborate calculations?

I suppose it makes us feel better to do it. It certainly makes more jobs. It is easier to "sell" it as a scheme.

FEDERAL TRADE COMMISSION AND THE REGULATION OF BUSINESS

By
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I am going to go back a little bit into history in discussing this subject. It is really necessary to understand something about the background of the Federal Trade Commission in order to understand the nature of its work.

Now as you all know, the Sherman Anti-Trust Act was passed in 1890. The records show that very little was done under that act in connection with the growth of the combination movement until several years later. The earlier cases which were brought under the Sherman Anti-Trust Act were generally cases against associations or groups of dealers engaged in associated activities of one kind or another to fix prices, restrict territory, to classify customers, and so on. The period immediately succeeding the passage of the Sherman Anti-Trust Act, of course, (and that perhaps accounts in part for the situation I have been describing), was one of great industrial depression.

Business went into the doldrums in the panic of 1893 and continued until about 1898 when it emerged in the McKinley Boom. Along with the McKinley Boom began what may be termed the great era of industrial consolidation in the United States. From 1898 practically up until 1903 the consolidation movement (number of consolidations formed per annum) ran into the hundreds in almost every year.

For years there may have been an exception to this statement in that in order to make these yearly totals you might be obliged to include some of the smaller combinations of a semi-local character such as brewing companies in certain cities. In some cities nearly all the brewing plants were hooked up together during this period.

Now, a large part of this development was in the form of the holding company type of organization. The reason for that is explainable partly in the terms of the passage of the celebrated holding company act by the State of New Jersey about 1889, or about the time of the passage of the Sherman Anti-Trust Act. Prior to that time, the general rule, speaking in broad terms, throughout the country was that one corporation could not acquire the stock of another corporation for purposes of control. You might acquire stock for an investment, but the general attitude then was that the acquisition of the stock for control purposes was not legal.

Prior to that year there had grown up the development of the so-called trust - the technical trust. I mean by that that the organization in question was actually a trust similar to the present business trust which is permitted now by statute in a great many states in this country. It was made up of corporations the stockholders of which deposited in the hands of various trustees a majority or more of capital stock of the various corporations, the trustees being given the full and complete power to vote and to handle this stock.

It was under that form of organization that the Standard Oil Trust

first developed, also the Sugar Trust, the Cotton Seed Oil Trust and others, all during this period of years from 1873 to 1890. The term trust as commonly used in this country comes from that very situation. The first type of large monopolistic combination that we knew in this country was this technical trust and the term has continued on down to the present day, applying to the formation of any large combination.

The courts very shortly after the beginning of this movement levied an attack upon this form of organization. The New York State Senate instituted an investigation of this form of organization about 1888. Simultaneously almost the Federal Government also undertook an investigation of "trusts". A little later in 1893 the New York State Legislature undertook another investigation into this type of combination. In the course of those investigations there was developed all the facts with regard to the organization of the present Standard Oil Trust, the Sugar Refining Companies, and so on. And it was largely on the basis of the information gathered in the first two of these investigations that the Sherman Anti-Trust Act was passed.

The state courts in the meantime had handed down several decisions outlawing this particular form of organization. Then just before the passage of the Sherman Act New Jersey passed its famous or infamous (whichever you like) holding company statute thereby permitting corporations organized in the State of New Jersey to hold the stocks of other organizations for purposes of control. This facilitated combination in a consolidated form, and paved the way for the great flood of combinations during 1898-1903.

During that period there were formed a very large proportion of all the great combinations whose names are now household words. That was the period of the organization of the National Biscuit Company, the International Paper Company, United States Steel, American Woolen, National Lead, and dozens of others which are now listed on the New York Stock Exchange.

In 1899 or thereabouts there began an investigation authorized by Congress and carried on under the supervision of the United States Industrial Commission, which made a report of some fifteen volumes regarding the whole transportation, trade and industrial situation in the United States. Some of those volumes - 1 and 13 - were devoted to the subject of trusts. Professor Jenks, whom some of you have heard of, was the chief examiner of witnesses at those hearings. There was a detailed and careful examination at those hearings of the instances and reasons for the growth of the consolidation movement that was taking place, and also of the alleged economies resulting from this combination movement - in other words, the possible resulting economies which would be effected by bringing together the plants of various corporations under a unified control.

That gives you I think, rather roughly, the background of regulation. In 1903, Congress passed an act which was known as the act creating the Bureau of Corporations in the Department of Commerce and Labor. This Act provided that this Bureau of Corporations should have the power to investigate the organization and management of corporations engaged in interstate commerce. In other words, back in 1903, there was created the first investigating agency, to go into these matters of the organization, conduct, practices, and consolidation of corporations and the like.

Many people when they talk about the Federal Trade Commission do not realize that substantially the same investigatory authority which the Com-

mission has at the present time has been on the statute books since 1903. They assume it is something that came in with the Commission. It did not.

There is no doubt I think that both the history of the period from 1898 to 1903, with the tremendous growth of consolidations and the report and recommendations of the United States Industrial Commission, played an important part in the decision of Congress to establish this Bureau. This Bureau of Corporations Act has sometimes been referred to as a Theodore Roosevelt Measure, it having been put on the books at that time.

There are statements contained in the earlier reports of the Bureau that one of the reasons that may have inspired this Act was the desire to get adequate publicity for a great many of the things that corporations were doing with the idea that publicity with regard to the facts would serve in some measure to check and retard the movement toward consolidation.

I have given all these details because it seems to me that if one wants to understand fully the work of the Commission he must realize that it goes back a good many years before the actual operations of the Federal Trade Commission began. This particular Bureau of Corporations did a great many things. It made a report on the transportation of petroleum which was followed by a report on the Standard Oil Company, which disclosed the existing situation with regard to railroad rebates, showing that the Standard Oil Company was receiving rebates not only on its own but also on the shipments of its competitors, in some cases. A similar investigation was made of the operations of the American Tobacco Company, and evidence gathered by the Bureau of Corporations in connection with the two inquiries was used very largely by the Department of Justice in connection with the prosecution brought for the dissolution of the oil and tobacco combinations. The Bureau also made reports on the steel corporations and various other industries during the course of its life.

The question of combination of monopoly continued to have a very prominent place in the thinking of leaders here in America, and there continued to be agitation on the question. Along in 1911-12-13 we have a whole series of Congressional investigations dealing with this question. What should be done about it? This was partly motivated by the fact that the Supreme Court in deciding the Oil and Tobacco cases and in ordering the dissolution of these combinations had established the celebrated "rule of reason" and a great many people dissented very vigorously from this rule.

At any rate the subject of further legislation began to be very strongly agitated between 1911-13, resulting in the passage of the Act creating the Federal Trade Commission.

This Act was passed in 1914 and it is interesting to note one particular fact about it. When it was introduced it contained substantially the same powers in somewhat elaborated form as had been given to the Bureau of Corporations and nothing more. The general investigatory power was made more dignified by creating a commission of five members, and placing the work in the hands of that body instead of in the hands of a Bureau functioning in a particular exedutive department.

It is true that the provisions for investigation contained in the present Section 6 of the Commission's Act were somewhat enlarged but the same basic concept was still there. Additional specific powers were given to it to acquire annual and special reports and its authority was elaborated in certain other provi-

sions, but essentially the present Section 6 represents the same idea as did the old Bureau of Corporations Act.

The Act, however, had been scarcely brought out when Mr. Raymond B. Stevens of New Hampshire, presented a dissenting report on this legislation in which he stated that it was necessary that this new legislation should prohibit unfair methods of competition in commerce. After considerable discussion and long debates the present Section 5 of the Trade Commission Act was added, giving the Commission jurisdiction to prevent unfair methods of competition in commerce. In one sense that came as an afterthought, the original purpose being general investigation, but over a period of years this has become, I suppose without question, the most important section of the Act.

At the time the discussion with regard to unfair competition was taking place in the Senate and in the House, we find developing two lines of thought with regard to it. One group desired to keep the legislation general, that is in the terms in which it now appears. The other group rather definitely favored specific enumeration. There were certain practices it was claimed which were so bad that the only way to treat them was to prohibit them specifically so that the courts would have no latitude in deciding whether or not they were unfair.

In fact some lists were drawn up, which I think you will find in the Debates, of dozens of these practices which it was proposed to outlaw by legislation. Two of these practices, price discrimination and exclusive and tying contracts were actually prohibited by sections 2 and 3 of the Clayton Anti-Trust Act, which was passed almost simultaneously with the Federal Trade Commission Act.

The debates indicate that these two specific prohibitions were put into the Clayton Act because of the fact that Congress felt that those practices were so bad that even though they believed that they might be regarded as unfair competition under Section 5 they did not want to take any chances. To be more specific, the prohibition of price discriminations was especially directed at what is commonly called local price-cutting. It had appeared throughout the records in the oil and tobacco cases that both those companies had engaged in the practice of cutting prices in particular areas while maintaining higher prices in other localities, for the purpose of eliminating their competitors. It was felt that that sort of thing should be permanently outlawed.

The exclusive and tying arrangement was directed against the United States Machinery Company and against the Dick Mimeograph Company. Some years before this there had been handed down a decision by the United States Supreme Court which had upheld a license restriction of the Dick Mimeograph Company requiring purchasers to buy ink, paper, and stencils only from the Dick Company, a decision which aroused a great outburst of dissatisfaction. The United Shoe Machinery Company similarly had a system of leasing and licensing arrangements under which the machinery of that company could be leased and used only in conjunction with all of the other machines which were similarly leased and licensed by it.

Under the terms of those agreements it was impossible for any concern to lease a machine or any part of a machine to any shoe manufacturer who had licenses from the United States Shoe Machinery Company without the machines being taken out of the plant by the United Company or without giving that company the right to take them out. They were thus both exclusive and tying agreements, requiring that no machine of the United Shoe Machinery Company should be used for manufacture of shoes except in conjunction with the other machines of that company.

There was also incorporated in the Clayton Anti-Trust Act two other Sections, one prohibiting interlocking directors, and one prohibiting, in addition, intercorporate stockholding.

Now let us consider the way in which the Commission works under these provisions which I have just mentioned.

The work of the Commission is divided into two divisions, not two technical divisions, but rather divisions of work. One is the legal work which may be said to relate to the enfordement of these statutes insofar as they prohibit corporations from doing certain things. The other division is this work under Section 6, which I have already referred to, namely, the investigation of the organization, conduct, and practices of corporations engaged in commerce.

The legal work of preventing unfair competition and violations of the Clayton Act is carried on under certain specified divisions- the Chief Counsel's Division, the Chief Examiner's Division, the Chief Trial Examiner's Division, and the Special Board of Investigation.

In handling cases complaints come into the Commission from various sources. These complaints go to the Chief Examiner, who may be said to be the chief legal investigating officer of the Commission. The Chief Examiner has a staff of field agents and others who are known as Examiners, whose duty is to visit the complainants in the first instance and also the parties complained against and investigate all the facts with reference to the complaint. After the investigation is completed, the Examiner makes a report to the Chief Examiner, stating what facts he has found and making his recommendations either for the issuance of the complaints or for the dismissal of the case. The Chief Examiner in turn reviews the findings, sends them back, if he deems it necessary, for further investigation and finally makes his report to the Commission, recommending issuance of a complaint or a dismissal.

If the Commission decides that there has been violation of any particular provisions of the laws the Commission issues its complaint, and that complaint is handled by the Chief Counsel, who is the chief legal officer of the Commission. It is the function of the Chief Counsel to draft these complaints for the Commission's approval and to try the cases on the Commission's complaint.

After the complaint is issued, the respondent has a certain period of time to answer, and then the case goes to trial. The persons in charg of the trials of cases are known as Trial Examiners who are under the supervision of the Chief Trial Examiner. Their function is to sit in these cases and to take testimony in much the same way as a master in Chancery. Both the Commission and respondent present their witnesses who are subjected to examination, and cross-examination as in any case in court. After the case is closed, the Chief Trial Examiner makes a report upon the case or reviews the case and makes his findings, and transmits them to the Commission.

The case is then argued before the Commission by the attorneys for the Commission and the respondent, and the Commission then either issues an order to cease from practice or dismisses the case on the ground that no violation of law has been shown.

So much for the formal legal procedure. The Commission has, however, another method of procedure in certain cases. It has, for example, the Special Board, which I referred to, which is a special board for the investigation of false and misleading advertising in the newspapers, magazines, and on the radio. This special board receives and investigates complaints of unfair advertising. If there is

an apparent violation of Section 5 it communicates with the parties using the advertising and endeavors to effect a stipulation. By that I mean an agreement between the Commission and the parties in question that they will discontinue the advertising which is regarded as being unfair competition. The great bulk of these cases, perhaps ninety to ninety-five per cent, are actually settled in this fashion by stipulation.

A similar stipulation procedure is also used in certain cases where an apparent violation of law has been found. In other words, the respondents are given an opportunity to cease the practice and to enter into a stipulation with the Commission to that effect. These stipulation procedures are handled through the Chief Trial Examiner, and he and his men draft the stipulations for the abandonment of the practices in question.

Now we come to Section 6 providing for general investigations of this work. Two divisions are engaged in investigation, the Chief Examiner's Division already described, which functions also in general investigations involving violation of law, and the Economic Division. The Economic Division, because of the comprehensive nature of the authority given to the Commission regarding investigation, has a very broad field. This division has investigated, for example, at one time or another, national wealth and income, power and gas, chain stores, stock dividends, cooperative marketing, cement, grain, sewing machines, and numerous other industries. Some of these investigations have been very extensive, taking years to complete. The chain store inquiry, for example, lasted four years. Thirty-four volumes or reports were published each one of which was devoted to some feature of chain store operations such as price policies, special discounts and allowances, private brands, shortweighing, and so on.

A good many of the Commission's reports have been in the nature of pioneering studies. Take, for instance, its three volumes of reports on futures trading in grain. They are 75 percent statistical, and comprise the first comprehensive statistical analysis of futures trading ever published.

In the case of bread the Commission made another very exhaustive and pioneering study of the cost of production. We distributed the figures for between two and three hundred bread plants, according to whether they were plants operated by miltiple-plant companies. These figures are in turn consolidated by size of plant using first an arithmetic and then a geometric basis of progression by volume of bread production and the results compared.

The results are very interesting in that they do not show very much advantage for the companies operating from two to several plants. This is the only broad statistical study of this character which has ever been made.

Similarly, I may say that the chain store inquiry was more or less pioneering work. We had very little definite information and still less statistical information about chain stores until this analysis by the Federal Trade Commission was undertaken. As a result of this investigation, there is today available a great deal of data about chain store operating methods and results.

Some of the Commission reports have resulted directly or indirectly in important legislation.

I think there can be no doubt that the information obtained by the Commission in the meat packing inquiry was quite directly responsible for the passage of the Packers and

Stockyards Act. All of you, I expect, have heard of the Commission's inquiry on power and gas utilities. I doubt that anybody will dispute the fact that the information disclosed in connection with that inquiry was an important factor in the passage of the recent legislation regulating electric utilities. The Federal Trade Commission's inquiry into Export Trade many years ago was also responsible in a large measure for the passage of the Webb-Pomerene Act. At least the Commission recommended the legislation on this subject that was subsequently adopted.

In the case of cotton, the Commission began an inquiry in the early 20's, and after a long study, came to the conclusion that the only thing to do from the standpoint of the correction of the existing discounts in the distant future months as compared with the cash and near month futures deliveries on the New York futures contracts should be made at points in the South. A report to that effect was written recommending that that system be adopted on the New York Cotton Exchange. It took six years for the New York Cotton Exchange to come around to the proposal but in 1929, the Exchange did adopt the system of outside delivery for their future contracts.

I may refer to one other thing which might have some interest for you, I think. The Federal Trade Commission's reports on cotton, on grain, and subsequently on coöperative marketing of farm products, are the first studies, I believe, that were ever made of the comparative costs of handling different farm products by coöperatives on the one hand, and by independent merchants on the other. Those of you who are interested can find comparisons of that kind in those reports for several agricultural products.

I might say just a word with reference to the organization of the Economic Division of the Federal Trade Commission for conducting general inquiries. We have a chief economist, with two assistant chiefs, of which I happen to be one. The assistant chief economists are the men who generally direct the conduct of particular inquiries. Besides that, we have two functional officers, a chief accountant and a chief statistician, who report directly to the chief economist. The chief statistician at certain times may be directly in charge of a particular investigation, or the chief economist, may take direct supervision of an inquiry in a pressure of several inquiries.

The assistant chiefs, the chief statistician, and the chief accountant, also function as advisers to the Chief Economist regarding the conduct of inquiries and the supervision of statistical and other general work that is involved.

Another matter which has a direct bearing on the matter of unfair methods of competition is that of trade practice conferences.

Trade practice conference procedure in the Commission has a rather interesting development historically. It arose about 1918 around the close of the War, as I recall it, or thereabouts. The Commission found in certain cases upon investigation of a particular trade practice, that not only one concern but practically every member of the industry was using the same practice. Naturally, the question arose, why should you proceed against one organization and not the others, or should you proceed at all? Obviously, if you are going to stop this practice, you must stop not one but everybody from using it. Out of this arose the idea of calling in all the representatives of the industry

using the practice complained of in an effort to correct the situation. That was the origin of the trade-practice conference.

If you were obliged to bring complaints against every one of say 70 or 80 concerns in the industry, it was also obvious that it would be a tremendously expensive procedure. The conclusion was, therefore, that both the expense and time might be saved by bringing in all the industry. Since that time, the trade practice conference work has steadily increased, many industries having asked for trade practice conferences for the elimination of various practices and abuses which exist or prevail in the industry. This work is under the jurisdiction of the Trade Practice Conference Board, composed of three members, who confer with the industry, both formally and informally, consider proposed rules and make recommendations as to what the trade practice conference rules for the industry should contain. The probabilities are, I assume, that in the future that work is going to expand. Nobody knows, but that seems to be very much the present indication.

DISCUSSION

Question: You mentioned the Clayton Act prohibiting interlocking directorates. Just how many directors in the different organizations would be required to call it an interlocking directorate? My impression is that there are a great many corporations today which have interlocking directorates with other corporations. What is the situation today with regard to this?

Answer: I could not tell you that because I do not know how far we have gone toward the elimination of it. I think there was quite an agitation and quite a decided tendency, as far as I know, to get rid of that situation. These prohibitions in many cases are qualified by the clauses in the Act as to whether the general effect may be to substantially lessen competition and to create a monopoly, and I cannot answer that question specifically because, frankly, I do not know. I have never made any check-up in that respect.

Question: I am interested in knowing whether there is a liaison maintained between the Federal Trade Commission and the Department of Justice in so far as the latter department responds to the enforcement of the anti-trust laws, and how is that effected?

Answer: There has always been an attempt at a liaison; that is to say, there has always been some discussion between the Commission and the Department of Justice with reference to specific matters. They have asked the Commission questions and the Commission makes inquiries of them. The Commission has also furnished data to the Department of Justice for action. There is no formal liaison arrangement but there have always been more or less informal contacts between the Department and the Commission one way or another. Sometimes there has been information that we have collected in our investigations which has been used by the Department of Justice, in certain cases in which they have proceeded under the Sherman Anti-Trust laws.

Question: You raised the point that the Commission has made an investigation in the cost of producing bread in the concerns of various sizes, but I do not recall that you gave the results, and I was interested in knowing a little more about that.

Answer: I did not make any statement about that because it is a little too difficult to make any general statements. In showing the difference in costs between the single and the multiple-plant outfits,

the figures are very detailed, so detailed, in fact, that I could not carry the exact classifications in my mind. One of the reasons for that would be the fact that our results covered a period of four years, and the number of plants that we had available was not the same in all four years. Therefore there is a variation in the results from year to year during that period. To try to generalize a statement in terms of all four years is rather difficult. I could only say this, negatively, that lower costs for the multiple-plant companies are not very definitely established by those figures. There is apparently some tendency in the larger size groups for the multiple-plant companies to show somewhat lower costs than the single plants, but we are also faced with the fact ~~of~~ that the very large plants among the single classes are relatively few so that the samples of the single plant costs in the higher-size ranges is very limited. The multiple-plant group has a much larger number of plants in these ranges. In the smaller sizes, the very small sizes of plants, the results are practically uniform in all years. The single-plant company costs were lower than those of the plants operated by multiple-plant companies. When you get into the higher ranges of size, there is some tendency in favor of the multiple plants, but this is qualified by the thin sample of single-plant company costs.

Question: I'd like to know what happens to a company that is found to be violating the law. Would it be given notice to desist without being given a penalty?

Answer: No penalty goes with an order to desist, unless they are subsequently found to be violating the order. Then the Commission goes into the courts and gets an order prohibiting them from continuing. The Commission's orders are not punitive in character. The only punitive characteristic comes from the order of the Court which can punish for contempt any subsequent violations of its order.

Question: What discretion does the Court have in upholding or not upholding the findings of the Commission?

Answer: The best answer I could probably make is that the law says: "The findings of the Commission, if supported by the testimony, shall be conclusive", or something to that effect. I think it is fair to say that this has been variously interpreted by the Courts, and the question always is present as to whether the Court feels the Commission's findings are sufficient and adequately supported by testimony. If the Court finds it is not, then they have a right to throw the case out. I may say that in the last 16 or 17 cases, or something like that number, in which the Commission has been in Court, the Commission has been uniformly upheld. Now I don't know what the nature of those cases was: nor and whether that record is going to be continued in the future. But at any rate, that is the record in recent cases and the Commission has had an almost continuous series of victories in the Courts now for some time. Sooner or later we may get a reversal however.

Question: After the Commission finds a certain practice contrary to law and unreasonable, will an action lie by a competitor of the company that is engaged in the practice to recover damages for the period previous to the finding of the Commission?

Answer: There are provisions for recovering damages in private

suits under the Clayton Act but not under the Federal Trade Commission Act. People frequently think of the Trade Commission Act as an anti-trust Act. This is not technically correct. The Clayton Act prohibiting price discriminations, exclusive and tieing contracts, holding corporations and interlocking directorates, is specifically an anti-trust act and damages, therefore, in private suits may lie under that Act, but not under the Trade Commission Act. It may be possible to find an order by the Commission under section 5 for a practice which a private party might claim was a violation also of the Sherman Anti-Trust or Clayton law, but you would have to prove that. A private party would have a better case if the Commission's order was made under the Clayton Act as well as Section 5 of the Trade Commission Act.

Question: Have there been any effects on the prices of particular commodities as the results of dissolution of monopolies or trusts in particular industries?

Answer: There has been little study made of that particular phase by the Bureau of Corporations, or by the Federal Trade Commission. The Bureau of Corporations just before the Trade Commission was organized, made a study of the effects of the tobacco dissolution, Volume III of the Report on the Tobacco Industry. There was some study of prices and also of the effects of the dissolution in the report as I recall it. The report indicated something to the effect that there was little change in prices. There was, however, a very great increase in competitive advertising.

More recently, there has been a study by Reavis Cox - I have forgotten the exact title of it, but it was a thesis at Columbia, which discusses the competitive situation following the tobacco dissolution.

Certain conditions are a matter of general knowledge, but have not been written up. For example, after the Standard Oil dissolution, the various constituent subsidiaries which made up the original Standard Oil trust and subsequently the Standard Oil Company of New Jersey, which succeeded the trust after the passage of the New Jersey Holding Company Act, maintained for a long time their original marketing territories. In other words, the Standard Oil of Indiana had a definite marketing territory; the Standard Oil of New York, and the Standard Oil of New Jersey had a definite territory prior to dissolution which was subsequently maintained. I understand that there has been a change in that respect in recent years.

Right now, of course, the price situation in cigarettes does indicate that some cigarette prices have come down, but of course, it is a long time since the tobacco dissolution, and the depression has had a great deal to do with prices, as well as the dissolution of the trust.

Question: In the case where the Commission has some choice about finding certain practices unfair under the Federal Trade Commission Act or the Clayton Anti-Trust Act, does it declare it a violation of policy or does it have any preference, or does it try to bring out all of the acts?

Answer: I would say that the practice has varied, and with it the decisions, very largely on the basis of the judgment of the Commission as to how the case should be handled. There have been cases where the Commission has proceeded against the particular practice under Section 5 and also under either Sections 2 or 3. I think the

question is one as to whether or not a practice is a violation of both statutes.

The debates in Congress would seem to indicate this interpretation. I would say that the inference would necessarily be that in all instances, violations of Sections 2 or 3 were also unfair methods of competition. Ido not make this as a statement of fact but I don't think that all cases under Sections 2 and 3 would also be brought under Section 5.

Please don't hold me for accuracy on that, because I am not certain.

Question: What were some of the Commission's findings in regard to the chain store investigations?

Answer: That is a pretty large order. We wrote a whole volume on it, about one hundred pages, and it is full of a good deal of law. I don't think I could really attempt to summarize it. I suggest that you ask for the final report of the Trade Commission on the chain store investigation. I might say that you could get any of the chain store reports by asking for them; they are all in print with the exception of one or two studies.

There are a good many things brought out in the investigation with regard to discounts and allowances. We had under survey some fourteen hundred manufacturers for all their discounts and allowances of every type. We tabulated all of them. You could find the percentage rates paid to different types of chains; the actual amount paid for volume, for advertising, for display, etc.

There was also an extensive volume on price policy, showing how the chain store is in a position by operating over a large territory to keep prices down or take a narrow margin in one area and take a higher margin in another. Sometimes those conditions may be covered by competitive situations. One man told me that - "It is no use. We just can't sell cigarettes in the Bowery section of New York City for the same price we can sell them on upper Broadway."

Question: Does the Commission have any definite attitude towards giving its orders or to its original jurisdictions?

Answers I can't answer that because it is a question of policy.

Question: You are not willing to express an opinion on that?

Answer: No.

Question: Is the jurisdiction of the Commission limited to the types of business that operate in interstate commerce?

Answer: That is right. It is restricted to corporations dealing in interstate commerce and has no authority over individuals.

Question: Would you say something, please, about the Better Business Bureaus? Do you ever have any contact with them, or are they practically confined to smaller transactions?

Answer: I don't know much about that except that I do know that the Commission, in certain cases, has contacted the Better Business Bureaus. There have also been cases where such bureaus have filed complaints with the Commission. We have had some contacts with them in connection with their work.

Question: I have a couple of questions. One is in regard as to how the Federal Trade Commission distinguishes between interstate and noninterstate commerce, and the other question I want to ask is on what grounds do you originate your investigations? Are they only on complain or may you start investigation yourself?

Answer: Answering the first question, the Act says that the Commission has jurisdiction over corpora-

tions.

As defined by the Act, these corporations are those engaged in interstate commerce. So that all we have to know is the fact that a corporation is engaged in commerce.

The other question I didn't quite get.

Question: Do you originate your investigations only on complaint, or may you originate them if you suspect that there are unfair methods?

Answer: There is no restriction on origination by the Commission. I mean that the general powers under Section 6 specifically authorize the Commission to undertake investigations on its own motion or at the direction of Congress or the President in certain cases. Complaints of violations of law may come in in any way. Anybody may write into the Commission and complain about something. At other times members of the staff may call to the attention of the Commission certain things that come to their attention. There is no limitation as to where complaints may originate.

You know something about the monetary or rather the financial situation in most Government Departments. Speaking generally, I think it is probably fair to say that most of the staffs are kept pretty busy with the money they have. When it comes to the question of hunting up cases, you simply don't have the time or the money to do it. But these complaints come in, of every sort and description, from all sorts of sources, some which are surprising. You never think of certain sources as being the ones from which complaints would originate. Nonetheless, they do.

Question: Do you think the tendency towards monopoly has shown any inclination to decline since the Commission started its work? Would there be any basis for making such a comparison?

Answer: I really don't think there is any very satisfactory basis for making those comparisons. This situation is in a constant state of flux. We had this terrific upswing in the movement for consolidation from 1898 to 1903 - it was a tremendous growth.

In 1901 the United States Steel Corporation was organized with a capital of \$550,000,000 preferred, of \$450,000,000 common, and \$300,000,000 of bonds. That was in 1901 - 34 years ago. Consider the fact that we have only one company in the industrial field that has capitalization that is comparable to that, and you get some measure as to the consolidation movement back in 1901.

I made a personal calculation as to capitalization of consolidations a great many years ago. I can't give you the exact figures. I tabulated the gross stocks and bonds issued by all the companies that I could find during this period 1898-1903.

Certain companies were recombined. Take for illustration, the Illinois Steel and Wire Company. This was formed by consolidation of certain plants in Illinois. The Illinois Steel and Wire Company became a constituent corporation of the American Steel and Wire Company. This became a constituent company of the American Steel and Wire Company of New Jersey. This company in time went into the United States Steel Company in 1901. There were three consolidations in a period of from two to three years. The capitalizations were turned into the Stock Exchange repeatedly.

I came out with a net total of several billion dollars of securities issued by combination from 1898-1903. It was a very high total after eliminating all these things.

The Panic came in 1907; the dissolution proceedings started; the Trade Commission and Clayton Acts came in 1914. I don't think there are on record any very great number of large consolidations that have been put through since the last date. I can't say that I have made any definite check-up, but none comes to my mind except one or two in the steel business. I think probably in some other lines there have been a few.

If you look back at the picture of the period from 1898 to 1903 and see what happened there, anything that happened in any six years since is not very large in comparison.

Question: Is the Commission going to be likely to use any of the reports of other agencies that duplicated their work? Are they likely to be of service to their records?

Answer: Well, as far as economic work is concerned, I rather doubt that they will, but I have had many business reports which have always been of some help to us in connection with particular economic studies. Generally, however, we like and prefer to get our own figures, and we usually do. We have a well-organized accounting staff, and we prefer to get our own data where we can, so that we know what the figures mean.

All these reports of the Brookings people dealing with the trade association questions, all the NRA reports dealing with such cases, are in many instances likely to be of considerable value. As far as NRA reports are concerned, we are trying to get them. Of some, however, there are only four or five copies in existence.

I have in mind particularly my own situation when I tried to get hold of a certain NRA report of which there were only a few copies. I spent the best part of an afternoon on the phone trying to get the report. I finally got it and it was a last carbon that you could only read if you spent a great deal of time.

There is no question in my mind that some of the information in connection with the NRA reports would be of great value to the Commission. They contain information in connection with the code operations which is bound to be of considerable service.

GOVERNMENT and the CONSUMER

By Dr. Clarence Ayres
Director Consumers Project
Department of Labor

I feel more at home here than I have any time since I have been in Washington. There is a certain academic calm that pervades this room that does not seem to prevail elsewhere, at least in those places to which I have penetrated.

It is, I suppose, altogether appropriate that consumption should be the last subject to be dealt with in this series of lectures. Consumption is the end of economic activity. It is the end toward which all economic activity is presumably conducted, and it is the end of the processes in a temporal sense also. In addition, it is the last thing that economists ever think of, and the very word itself is the name of a deadly disease. A very interesting subject for some graduate student to work out a doctor's thesis on would be the extent of the neglect of consumption by the classical economists. Another one would be the extent and causes of the neglect of the subject by governments and other responsible authorities.

Of course, it might be argued that problems of consumption are adequately dealt with at other points in the theoretical structure of economics and the administrative structure of government, but that depends entirely on what you mean by consumption. There is no subject in the field of economics which bears more scars, or deeper scars of academic logic chopping than consumption. It is sometimes defined in such a way as to make it consistent with the whole economic process. If consumption and production are parallel, a continuous process, why then it can be argued of course that every economic activity is a consumer activity in exactly the same degree as it is a producing activity.

If all production is a contribution of services, as many economists have argued--Professor Pigou only recently--that means that it is a transitional process, or a metabolism to which the anabolism of production and the catabolism of consumption are equally essential. Well, of course, the effect of any such definition of consumption as that is to give consumption universal meaning, and no meaning at all. It ceases to be an essential aspect or phase of the economic process, or to represent any special set of problems, and becomes simply one of the synonym names; one of the tautological terms with which economic theory is so replete.

If you stop and think over what we mean by consumption, you will find that we extend our definition too far and also confine it within too narrow limits, so that we make the opposite mistake in each of two different phases of consumption. When we think of consumption as a process, comparing it with production, we are very prone to extend it throughout the whole economic process. Thus it has been argued by responsible government administrators that the protection of the consuming interest extends throughout the whole of industrial society so that there is no region in the industrial process to which the interests of consumers' counsels are more applicable than any other region. Such a definition seems to me to become meaningless by becoming universal.

But, on the other hand, another defect to which our reasoning on the subject of consumption is only too prone is that of confining the de-

finition within too narrow limits when we are thinking of the consumers. Thus, in facing the problem of consumption as officers of the government, we sometimes think that it is our particular business to represent the interests of a certain special group, the consumers. We sometimes think that the consumers must be distinguished in this business of representation from producers. Thus I have heard quite intelligent, sensible, responsible, sane people— relatively sane—argue that it is the business of any consumer agency to represent the interests of organized or unorganized groups of consumers as against the interests of producers and that wherever any consumer organization is under discussion, the most important thing is to ensure that no representative of any producer shall be a member of that organization, like a "capitalist stool pigeon" in a labor organization, and so on.

Of course, the same point can be made with reference to labor. It can also be argued that the interests of labor sometimes conflict with those of the consumer. Any given trade union, for example, may be in a position to advance the interests of its special members by wage bargaining, the effect of which will be to pass on to the consumer the additional cost of the wage increase of that particular class of laborers. Such being the case, it is argued, the interests of consumers as a group, as a class of people, are divergent from the interests of labor, at all events, this particular group of laborers.

It seems to me that that line of argument is both intellectually spurious, and also administratively a serious danger to clarity of thinking and consistency of action. In order for any such special group to be constituted, it must necessarily perform the function by which that group is defined, and not perform the functions by which the other groups are defined. So that, if you are to argue that consumers must be regarded as a special group or class, whose interests are divergent from producers, then it must be presumed that there are some consumers who are not producers, and vice versa. Now, of course, it is perfectly obvious that there are not, that there is no consumer—well, if we except certain very special pathological cases, physically and socially pathological. I mean to say that a hospital patient may be a consumer and not a producer, although it might be argued that he gives employment to someone. I think that possibly Bernard Mandevill and Henry Seager would have argued that at all events such a patient gives employment. There may be socially pathological cases in which certain people do have no visible means of support, that is, engage in no consistent, constructive effort of any kind. Of course, barring the effort of costumery and make-up, and so on, which no doubt is very considerable, but is not classed among gainful occupations in the census rolls. Barring those few exceptions, everyone is a producer.

Any organized group identifying itself as a consumer organization will, of course, consist of individuals each one of whom belongs to other organized producers' groups. In this sense the distinction is by no means a theoretical one but is a practical distinction quite on the level of the distinction between employers and employees; that is, the consumer is not a special class in the sense in which employees are a special class. Very few employees are also employers, and employers as a group are not also employees. In order to imagine a situation that would be practically analogous to the relation of consumers to producers in the field of the employer-employee relationship, you would have to conceive of a situation in which every employer was also himself in person a laborer, that is to say, spends a certain portion of his time working for wages; and

every worker was also himself an employer of labor in some other capacity at some other portion of his time. Because, of course, that is the situation as regards producers and consumers. What you are talking about here at this moment is not the fact that producers have certain vague remote interests in consuming. Every producer consumes food, and clothes, and shelter, and so on, in exactly the same fashion as every individual member of the population: in fact, the greater producer he is, the greater consumer he is. And every consumer, of course, spends a very considerable part of his time gainfully employed, that is to say, as a producer.

The attempt to define the consumer group as a special group has to be given up because it just won't hold water intellectually. Of course the interest in that type of definition is a very practical interest. It is sometimes argued that what we should do in the government is to represent organized pressure groups of consumers. You will find in the Brookings report on the N.R.A. a very interesting chapter on the work of the Consumers' Advisory Board of the N.R.A. in which this point is very clearly made by Professor Paul Homan of Cornell University, that while theoretically the Consumers' Advisory Board had a more potent clientele than any other wing of the Recovery Administration, actually the size of its clientele was self-defeating. The fact that when you get right down to it the consumer is everybody means that there is no such thing as a consumer pressure group and never can be. There may be special consumer pressure groups. I mean to say you might, conceivably, get together an international amalgamated association of peanut eaters, which would present their special interest as against the rest of the population. You might even, of course, get special pressure group organizations representing special types of consumer distribution, like various types of cooperative organizations.

Of course, in the countries in which cooperatives have made the greatest headway, it is true that the cooperatives have been associated with special political parties. In some countries, for example, such as Norway and Sweden, the cooperatives have themselves constituted a special political party. You may get special consumer pressure groups, but to think of the consumer as a special class or division of the population, susceptible of being organized into consumer pressure groups, is just to think wrongly. Consumption is not that sort of thing, and that sort of organization simply is not possible under the circumstances.

Another defect of the attempt to represent the consumer in the government, to do something about the consumer......I do not mean to carp! Of course everyone knows that the consumer has only recently become articulate in governmental halls. Government agencies acting in the avowed interest of consumers are, as yet, very few and those few are very recent. Their activities are undergoing definition. They are as yet, perhaps, not fully oriented. We are in process of finding orientation for them, and it is a big job. Another difficulty which we encounter as a result of defining consumer interests too broadly and defining the consumer group too narrowly is the presumption that the function of consumer representation in the government is a protective function; protective of the consumer group, of consumers as a class, wherever the interests of consumers conflict with those of producers at any point in the whole industrial process.

According to that conception, in short, the consumer interest is something like the still small voice of conscience. We say the consumer

interest is the public interest. Well, the consumer interest is the public interest in a certain sense, that is to say, the consumer is the public. Nevertheless, to define the consumers' interest as the public interest in such a way as to establish a complete identity in the minds of the public, and of the government, amounts to saying not only that the consumers' interest is the public interest but also that the public interest is the consumers' interest at all points in all problems. Any such identification as that has the effect of saddling the poor, unfortunate consumer agency with the entire burden of the public conscience.

Now, the consumer agencies are not sufficiently developed for that. The still, small voice of conscience is all very well. The consumers' agency can be still and, up to the present time, such consumer agencies as we have are certainly small. But that they should undertake the function in the public conscience, that we should think of the protection of the interest of the consumer as being tantamount to maintaining public decency, of honesty, fair dealing, upright industrial contact throughout the whole structure of business: that is simply a fantastic overstatement of the consumer problem.

Actually, of course, when we are not proposing to be administrative or theoretical, we find it easy enough to define what we mean by consuming and what we mean by consumers. Economists may spin fine arguments to the effect that the mine consumes picks and shovels, or, say railway transportation; the smelter consumes ore; the rolling mill consumes ingots; the railway builder consumes the product of the rolling mill; and the transportation industry consumes the product of the railway builder; and then you have got around to the starting point of the circle again--the mine consumes transportation, and so on, around and around. Nevertheless, when we are thinking of the problems of the consumer on the sidewalk, I mean to say outside of our seminars, outside the covers of our economic treatises, and outside the government offices, we all understand perfectly clearly that what we mean by consuming is possessing ourselves of end products of industry, and using them up. The using up--of course it takes different periods of time. A well-built house may last several generations, but it is being used up throughout that entire process. A suit of clothes takes longer to use up than a dinner, nevertheless it is being used up from the moment it is put on, once it has gone off the shelves of business, when it has been put on, and draped about the figure of the ultimate consumer.

When we talk about the ultimate consumer, of course, what we mean is the real consumer, the consumer in whom all sensible people are interested, the consumer whose problems constitute the special difficulty with which we are confronted, if indeed we are confronted with any special difficulties and are not merely using the word as a synonym for all the old difficulties we ever had. And we are implying that the non-ultimate consumer is not a consumer at all, he is just a figment of the imaginations of economists.

The same thing, of course, is true of the function of consuming. It is that of possessing in ourselves and using up. And that which is so consumed is consumers' goods. At this point, interesting enough, no confusion has ever arisen. The distinction between consumers' goods and producers' goods is precisely the distinction between goods which are passing down the throat of the ultimate consumer, which are actually being pulled over the legs of the ultimate consumer, and goods which are not undergoing such processes. A pair of trousers is not necessarily consumers' goods; it depends entirely

on whether somebody is wearing them. Food is capital. It is capital on the shelves and in the refrigerators of warehousemen, wholesalers, jobbers, and even retailers. The shanks of meat hanging in the butcher's refrigerator constitute capital, circulating capital. That meat becomes consumers' goods the minute it is cut off the shank and handed to a purchaser whose intent is to eat the meat, and the consuming is the process of possessing ourselves of that meat with intent to eat it, and proceeding to do so. At that point no confusion has ever existed.

Consumers' goods are not a special type of goods. I mean to say, you cannot take a picture and identify consumers' goods in the picture, except you take a picture of somebody eating them or wearing them. The function is perfectly clear in terms of the goods. Very well: consumers goods are goods which are undergoing consumption in the sense in which that word is also used to designate a disease. That disease, phthisis, or tuberculosis, is so called because it consumes the body. It uses it up. The process of using up is consumption, and anyone is a consumer and everyone is a consumer at the moment when and to the degree to which he possesses himself of things with the intent of using them up and actually does so.

Now then, our special problems—the theoretical economic problems and the governmental administrative problems of defending the consumers' interest—must be understood in terms of our clarification of that interest and our definition of consumption, consumers, and consumers' goods. What are those special problems? It seems to me that there are two major problems with which we are presented by the special status of consumers' goods, and the consuming function, under modern industrial society. It seems to me a great mistake to attempt to define the representation of consumers interests in terms of protecting and preventing not only because what you are then committed to protecting and preventing runs all through the whole range of business activity, but also because your functions are wholly negative as they are usually defined. The representation of consumers' interests, so conceived, is a matter of estoppment. "Go and find what Johnny is doing and stop him"—one could translate that into formal terms of the Consumers' Advisory Board very easily. Go and find what the code authorities are doing and stop them: something like that was the function of the Consumers' Advisory Board. That is not adequate because it does not represent any positive policy. But there are two respects, it seems to me, in which an affirmative, positive policy is demanded of us by very special pressing problems.

First, as regards consumers' goods. It used to be said that the buyer must beware. That principle, insofar as it was ever applicable, insofar as it was ever just, applied to a situation in which buyers understood the processes and materials of production very nearly as well as the producers themselves. The grain was all grown in the same region in which it was milled. If any of it was infected with rust, everybody in the community knew the danger. I mean to say that if the season was particularly damp and the grain mildewed in the shock, everybody in the community knew it and knew what to look out for in that season's flour. All the grain of the community was milled within the village itself. The merry miller with his dusty apron is one of the leading diguros of our European folklore. The same thing is true, of course, of all the other productive processes and products. Everyone in the community had an

opportunity to watch the cobbler at his work and to see what kind of materials he used to adulterate his product. You know the old stanza about the purple cow: "I never saw a purple cow; I never hope to see one; but judging by this morning's milk, there certainly must be one."

Everybody in the community knew the well from which the milk was drawn and if the dairyman was seen of an early morning making too many trips back and forth to the well, everyone in the community knew what it was all about and what to do about it. We do not need to dwell on that. It is sufficiently obvious that the whole institutional and technological background of the treatment of consumers, the traditional treatment of consumers, was changed by industrial society. Industry and society have presented us with a situation in which the net product of industry is most complex and mysterious and obscure. We do not know what is inside most of the things we buy. You buy a metal cabinet - you can buy them for just a few dollars now - out of which, if you twiddle a dial, ether waves are snatched out of space and booming voices tell you all about wheaties. Our refrigerating is done mechanically now. We ride in mechanical vehicles, etc. It is sufficiently obvious that consumers' goods are extremely intricate and complex. No one but a very special kind of chemist nowadays can tell what is in the cake you bring home from the baker. Has such and such chemical been used to produce such and such a color effect or weighting effect, etc.

Miss O'Brien was telling just recently about something here in Washington. A young woman bought a towel at a Washington notion shop, you know, what we used to call a Turkish bath towel. It seemed a good, substantial, hefty sort of towel. There was a whole lot to it. She passed it through her hands and it seemed as though she was getting a pretty hefty product. But when she washed it, it emerged from the wash all lumpy. She couldn't understand why it was all lumpy, but she had heard that they had some testing apparatus over at the Bureau of Home Economics; so she brought it there and showed it to Miss O'Brien, and she said, "Well, those lumps are clay." The girl was dumbfounded. She had never even known that manufacturers weighted cotton thread with clay. Of course, it is done before the towel is made up. It is done in the yarn itself. But when the towel is put in the wash, the clay moves around and lumps and forms those masses. Miss O'Brien proceeded to wash all the clay out of that towel, and she now has a little test tube with about two inches of clay removed from one towel.

The processes of industry are so complex and the tricks of the trade are so infinitely numerous that it is impossible that industrial society should proceed on the principle, "Caveat Emptor" any longer. Whether or not that principle was ever valid, it certainly is not valid now. No one would argue that that principle should be adhered to with respect to the entire range of consumers' goods. If the proposal were to be made that all pure food and drugs legislation should be wiped off the books and that the Foods and Drugs Administration close up permanently, you would not find a business man in the land who would accept any such proposal as that. On the contrary, one interesting circumstance with respect to S 5, the Pure Food and Drugs bill which has received most discussion in the present Congress, is the fact that the drug industry is fairly solidly lined up behind it. Whether that is a recommendation of the bill or the reverse, I don't know, but it is an illustration which serves our purpose here. Everyone realizes that some sort of scrutiny of consumers' goods

is thrust upon us by the complexity of modern industry.

What form is that scrutiny to take? There you have a very considerable administrative problem. For example, everyone knows the discussion, in connection with the foods, drugs and cosmetics legislation to which I have just referred, over the relative merits of the Food and Drugs Administration and the Federal Trade Commission, as administrative agencies. Let's not go into that, but I mention it only to indicate that at every single point, there are difficult, serious administrative problems. But this we can say, I think, that the buyer is entitled to know what he is buying.

We have had some interesting experiences with consumers' county councils which were first organized in the first part of 1934 by the consumers' division of the National Emergency Council, Mrs. Rumsey's special interest. Some of those consumers' county councils have done some interesting things. Some of them have attempted to scrutinize various consumers' goods in their immediate vicinity, have done some testing and have distributed the results of the tests amongst their members, etc., and occasionally we have had complaints about that. When I came to the Consumers' Project this spring, a canner had appealed to a local political friend, who in turn had appealed to a United States Senator from that State about some grading of canned goods that had been done by one of our county councils. I didn't know anything about those canned goods. I didn't know whether that grading was accurate or not. I felt pretty sure that if it was not accurate, it was simply a mistake, and that if the mistake could be pointed out, that the people who had conducted the test would be only too glad to acknowledge it and to correct whatever mistakes they might conceivably have made in grading. But of the question of the right of those people to conduct those tests, it seems to me there is no issue at all. At all events, I put it up to the Senator: Do you question the right of consumers to scrutinize goods which are being exposed for sale?

It is not a matter of privacy, of individual liberty. I mean to say you can fabricate any kind of breakfast food you like in your own house, feed it to your children, if you want, so long as the juvenile protective agency does not get after you; but when you offer it for sale you have then, it seems to me, come out in public. You are no longer a private citizen directing his private affairs in his own way. You are performing a public function. I think I am moving in the direction of saying yuractivities are affected with the public interest. If they are not, I don't know what affection of the public interest means. Possibly they are not affecting the public interest in the technical sense in which that phrase is applied to public utilities, but that such goods should be subject to scrutiny, I do not believe anybody will deny. Thus I think that if, for example, you should propose to sell a suit of clothes in a sealed paper bag, I think that you would soon discover what the attitude of the public is on such a subject as that.

Now that means that we are presented with a very considerable problem which we have only just scratched, the problem of knowing what is in the paper bag. What to do about it - that remains to be determined at a thousand different points. But the first thing to be determined is what is in the bag. On this side of the issue, therefore, I should be inclined to say that the most important thing that Government could do for the consumer is to describe consumers' goods.

What does the phrase "all Wool" mean? Does it mean woven of yarn the warp and woof of which both consist of yarns containing no other fibre than that shorn from the back of a sheep, or does it mean that both the warp and the woof consist of yarns which contain some fibres from the back of a sheep, or what? It seems to me that that sort of problem, the problem of defining and describing, encyclopedically, if you like, is a governmental problem because it transcends the powers of all other agencies. It should be done for industry as a whole. Of course, I mean to say if you just think of it in terms of Mr. Hoover's celebrated problem of the sizes of bolts and nuts, obviously it is to the interest of industry as a whole that the sizes of bolts and nuts should be standardized. It would be possible, of course, to devise a system whereby bolts and nuts were of different sizes and different threading for practically every different device, so that you could not use an automobile bolt on a lawn mower and vice versa. But [illegible] such gadgets can be standardized, defined, specified, so that the gadgets, the fabrics, the materials, whatever it is you are talking about, are known by the same names wherever they are used.

It seems to me there can be no argument about that. It would be greatly to the advantage of all business that such standardization should be effected. Take, if you like, such a simple thing as errors in colors, etc. There is absolutely no reason why all colors should not be specified in such a way that a certain color, name or formula would be applicable to any conceivable fabric or material. It could be specified, as a matter of fact, by a number and a letter, or what. Only just recently I saw something, it seems to me it was in <u>Time</u>, to the effect that some great genius, some colossal intellect, had conceived the idea of applying the color wheel to the designation of color. The editor who read this had evidently never heard of a color wheel before and thought this was a brand new contrivance to science which had just sprung full-blown from the brow of this no-doubt Harvard genius. Actually, of course, the color wheel is a very ancient device. It has been used in elementary school laboratories for a half century and obviously may be applied to these analytical problems very easily. I mean to say it is of course quite true that any color can be indicated by a very simple formula which anybody could represent on a color wheel. Thus your Sears-Roebuck catalog would say with respect to a gingham housedress, 1, 2, 3, 4, x, y, z, and you would have a little two-bit color wheel as a part of your regular equipment in your sewing room, and would set the numbers of your color wheel by these letters and spin the wheel, and there is the color and it would show you what color it is without a hairbreadth's deviation. Anybody who has ever played with a color wheel in a school knows how very fine the differences are that can be represented and distinguished on a color wheel. That is the sort of thing we are talking about: that the Government or somebody should undertake to reduce the preposterous confusion and bewilderment of the designation of consumers' goods to some sort of reason.

It seems to me beyond argument that the Government must do it. I should even go further than that and say definitely, I believe it will be done on a very extensive scale within a very short time. It seems to me it is a matter now of years rather than of decades. I should say that even within our lifetime, the whole technique of description of consumers' goods will be completely altered. It is bound to be. It is impossible that an intelligent people should stagger along indefinitely in the haze of bewilder-

ment with respect to the things they use throughout their lives and in all their variety of activities and not know what they are, fish, fowl, or good red herring. It is impossible. Even the multiplication of fabrics and materials, etc., which has occurred in the short time that has elapsed since the war, less than two decades - all the new synthetic fibres and papers and other sorts of materials: that in itself, it seems to me, is the stimulus which is going to produce this movement.

Perhaps I should not say this, but it is something that we have thought about a great deal in the Consumers' Project, and although we are a small organization and probably won't be able to accomplish very much, something along this line is what we would like to do. We talk in terms of an index of supply, sort of an encyclopedia of consumers' goods. As a symbol of what we mean take the United States Pharmacopoeia. With all due respect to the work of Harvey Wiley on the original Food and Drugs Act and the herculean efforts of subsequent Food and Drug Administrations, I think that the United States Pharmacopoeia is probably more important. That is to say I think that if we can go into a drug store and buy a little powder and put it in our mouths with relative assurance that we won't immediately go into a cataleptic fit and die, that is due chiefly to the existence of the United States Pharmacopoeia. That is to say, the drugs are standardized, so that the doctor can write out a little formula with the absolute assurance that the local pharmacist will put precisely that in the little paper twill and nothing else. When you think of what might happen when you put a white powder in your mouth and take a swallow of water after it, and then think of the amazing assurance with which we do precisely that, you begin to realize what we did to the scientific designation of the products which are used by pharmacists and are prescribed by doctors and taken by all of us. Now that is what we are talking about. Isn't it possible for an intelligent community to describe all its goods? Why not? Is there any reason why it should not do it? I don't think of any.

Of course, there is another problem even more important in the long run, which is also quite definitely a consumer problem. We sometimes get very tired of arguing about the sizes of peas in cans. It seems a little fatuous. It seems as though it really is not the important thing. After all, even supposing that you could define yarns in such a way that you could tell by a glance at the label whether those socks would endure a wash or not, still that doesn't seem to be a life and death problem. What are consumers chiefly interested in? When you ask the question in that form the answer is pretty obvious, isn't it, -- purchasing power.

If you give people enough purchasing power, it doesn't matter very much whether they are gypped by a store selling them a towel with a little clay in it. If they are in sufficiently comfortable circumstances, one little towel more or less isn't going to hurt very much. I am not arguing at all that we should ignore other problems because of the importance of the problem of purchasing power, but I am arguing that purchasing power is more important than any particular purchase.

That, also, it seems to me, is a consumer problem. It is a consumer problem rather than a producer problem for this reason. Industrial society has been giving us a very pretty exhibition in recent years of the defect of our present productive organization precisely at this point of the distribution of purchasing power. Our modern industrial system

is extraordinarily efficient from the point of view of turning out goods. It turns out goods in tremendous quantity and incredible variety, but there is just one thing it won't do satisfactorily, and that is distribute purchasing power. Now why it won't is a very long and complex story. It might perhaps be summarized in some such terms as these.

The competitive process whereby all business is organized in terms of bidding, various agents bidding against each other for materials, partially processed goods and for labor, etc., is perhaps effective enough in the guidance which it affords to individuals in situations in which they are called upon to make individual judgments. I mean if you are trying to decide what profession to go into, well, the fact that you are going to see a lot of teachers incapable of ever locating a position, all over the landscape, may be perhaps a very valuable observation to you in deciding not to become a teacher, or an architect, or what, and you may become a business man. If you are attempting to make up your mind whether you shall stock a certain line or not, the fact that you see unsold goods along those lines on the shelves of other business men, is perhaps a valuable guide to you in making that individual decision. In guiding individual decisions, the competitive structure of business has perhaps been extraordinarily successful.

Stop and look at the ant-hill of industrial society every now and then. Consider the hundreds and thousands and millions of people who are buzzing around, each one pursuing his own interest. Consider the fact that no one has told them where to go or what to do. Under a system of economic individualism, each one decides for himself. That the complex affairs of industrial society should be conducted at all in such a state of anarchy is perhaps sufficiently amazing. It has always seemed so to me. Maybe I am morbid on the subject, but as a small child, like William Ellery Leonard, who was frightened by locomotives, I used to be fascinated by railway trains. In the little town where I grew up, the faces of the people on the streets were sufficiently familiar so it didn't occur to me to wonder who they were, where they were from and what they were doing. I knew them. That was Johnny the grocer-man, etc. But you get on a train and it is full of strangers and they are all going somewhere else. Now where did they come from and where are they going? Ask that question for industrial society as a whole and you begin to have that sense of amazement which you should feel in the presence of the competitive order of economic individualism. It has been successful to an amazing degree. It really is quite preposterous that communities as large as those of modern industrial society - of course, the largest human communities which have ever existed - can somehow or other find their way about in the world, interweaving their activities without any general plan at all, without any strategy board, no superior direction, just as a result of everybody minding his own business. That is sufficiently astonishing. We don't need to feel badly if we find that that system of conducting affairs is not absolutely perfect.

Successful as it may have been in guiding decisions of individuals, with individual riders on the train, each one getting out at his own station, each one bent on commencing his own business and not asking any questions of the conductor, so that the conductor in spite of his uniform has no conductorial powers at all, the passengers getting on and off as they please: yet it may still be that that method of conducting affairs is subject to a quite critical defect - the defect of cross traffic.

Think of it in another set of terms. How many times have we been on crowded trains? How many times have we been

on empty trains, ridden on trains in which there were perhaps five cars and only two other passengers? That is what I am thinking of. Industrial society conducted on a basis of economic individualism has presented us with an amazing spectacle of efficient productive organization, but it has also, perhaps in comparatively recent years, commenced to exhibit a very serious defect in terms of the mass distribution of purchasing power. Whatever may be said of the efficiency with which our personal arrangements take hold of individual workers, it is quite obvious that the mass effect, the gross effect, of our productive organization, by virtue of which purchasing power is disbursed in the form of interest, rent, divident payments, profits and wages, is highly unsatisfactory. It is quite obvious that we have not disbursed enough purchasing power.

How do we know that? Because the product of industry is not bought. We do not have to ask the question by whom is it not bought. That is not what we are talking about. We are talking simply about the fact that the purchasing power is not disbursed. How do we know that it is not disbursed? Because the product of industry is not purchased. It is not purchased for the simple reason that people do not have the wherewithal to purchase it.

Now, then, the most important consumer problem is that of the distribution of purchasing power. How that principle can be dealt with remains to be seen. That it must be dealt with, it seems to me, is the chief duty of any consumer agency to point out, to insist upon and to reiterate. You cannot solve the problem of the consumer without solving the problem of the distribution of purchasing power. You cannot put goods down the throats of the people who will use them up except by providing those people with purchasing power. The provision of purchasing power is notably deficient. We are going to have to do something about it on a very substantial scale. If we do not, somebody else will.

(See next page for discussion)

DISCUSSION

Question-

Do you think the consumers' cooperative movement affords us substantial means for better distribution of purchasing power?

Answer-

No. Not for a better distribution of purchasing power. It seems to me that the cooperative movement attacks the problem from the other side - what goods we are purchasing with our purchasing power. The cooperative movement - we do not have any other general word, has been a leader in regard to labeling, everything on that side of the picture, fair prices for honest products, etc. Of course, it is a production-for-use and not-for-profit sort of organization, to be sure, but unless you are thinking of a completely cooperative society, it does not seem to me to affect the case except ever so slightly on the side of the distribution of purchasing power. If what you mean is the organization of the whole of industry on a cooperative basis, - with no profits, etc., the workers owning the plant and all that sort of thing, well, it may be; but that is something so remote from present actualities that it does not seem to me to be counted on.

Question-

You said if we make no effort to solve the problem, someone else will.

Answer-

How many are out in France this morning?

Question-

I was interested in knowing in just what direction you look for that effort.

Answer-

I put my head under the covers and try not to see in any direction. It seems to me that the problems are exactly the same whoever attacks them. I have a feeling that the passage of time will exhibit more and more concurrences between the different explosive attempts to solve these problems in other parts of the world such as Russia, Germany and Italy, etc. The problems are just the same in all of those places.

Question-

Do you think the organization of labor would not have a great deal to do with the distribution of purchasing power, particularly organized industrially?

Answer-

Of course, when you start to talk about the organization of labor, you have bitten off another great big mouthful. A great deal depends on whether you mean some ideal of organized labor very different from the present actuality, or whether you mean organized labor as at present organized. If you could imagine all labor to be organized on a united front and by very intelligent and high-mended leaders, etc., I should imagine that that would be a very desirable situation from the point of view of the distribution of mass purchasing power. Short of that, the actuality is rather spotted, as William James remarked.

Question-

I had an idea that that would eventually come to pass.

Answer-

Of course, there again you raise the question of a totalitarian State. I was talking in totalitarian terms. The only countries in which all labor is organized are Russia and Germany and Italy.

Question-

Isn't the problem today for the consumer pretty much to be sure that he gets back at least a reasonable proportion of the effort that he puts out - in other words, the effort that he puts out in producing goods comes back to him in his consumers goods?

Answer-

I'd like to speak frankly, but with a very clear understanding that there is nothing personal in it at all: it seems to me that this is just dumb nonsense. You know what we are doing when we talk that language. We are trying to put the milk of human kindness into the dry sawdust of economic theory and make a bowl of breakfast food. No. You cannot eat sawdust, not even with Grade A cream. The fact is, I think - this of course represents one wing of economic opinion - the old theory of productivity is just tommyrot, from beginning to end. Whenever you start talking about the disbursement of income in terms of a supposed balance between what somebody has done and what he has received, you are talking the language of "as if," I think. Take it in any human situation that you know anything about, the human beings with whose work you are most familiar - with me it would be a university department - and start discussing the salaries in terms of the real, intellectual contribution of those people: who in the dean's opinion are really contributing and what their real intellectual contribution is. There may be somebody who seems to be stumbling around and his mind seems to be in a daze, as the students are all convinced; and 25 years later you may discover that it was because he was working with a set of ideas which were just beginning to emerge into clarity, and that he was the prophet of a new age and his students will be the only ones that will understand this thing. How can you tell what is the true intellectual contribution of a colleague of yours? I say the only thing is in terms of age and number of children, or because he is older than the rest of us, etc.

Somebody says, well, why should you pay a person more just because he gets a bit older? It has no relation

to what he does, but a relation to what people thinks he does or some other value. I knew a fellow one time who had been a very highly paid man, in a very high position, as a group of us thought, just because of the way he blinked his eyebrows. He made everybody think he knew everything that was going on. Actually, he didn't know a thing.

Question-

I was thinking of the fact that a product costs so much to produce and then when the man who works in the factory goes to buy that product, he finds added on to it such a large additional price.

Answer-

It seems to me that it doesn't make much difference how the purchasing power is disbursed. How do you treat your children? I know some people who never give their children anything. They let their children earn it. They offer a recompense for washing dishes, etc. I know other children who wash just as many dishes and receive an allowance that has no relation to their washing dishes. They get the same amount, practically. What difference does it make? The important thing is that the children have the wherewithal to go to the movies, for instance. What I am thinking of is the gross problem of distributing purchasing power. I should be willing to argue in favor of dropping it from airplanes. Having been a slacker in 1917 because I had a small baby and my wife seemed to think that it was improper for a young new father to rush off to war, I feel myself a little bit at a disadvantage in discussing such things as the bonus, but I think a much better argument, economically, can be made for dropping money out of airplanes than the soldiers' bonus. It is true that the soldiers' bonus distributes purchasing power; it stimulates buying. I see the shop windows all over town full of suggestions as to how the bonus should be spent. The bonus should stimulate buying. I think if you should pick up a $20 bill dropped out of an airplane you probably would be much more likely to spend it than if you had earned it by working overtime, and it has this great advantage that it would be bestowed upon the just and the unjust like the gentle rain from heaven, whereas the soldiers' bonus goes only to the just, leaving the unjust out in the cold.

What you are thinking of is some arduous way of distributing purchasing power. I don't know what that means. It seems to me that from the consumer point of view, what we are confronted with is a deficiency of consumption. How do you correct a deficiency of consumption? By distributing purchasing power. But suppose you disbursed it to the wrong people! Who are the wrong people? I don't know and don't care. I think there is a little to be said for giving it to the very poor, not because the very poor are deserving, in fact I should almost be willing to grant that maybe it would corrupt their character. Maybe so. Too bad, to be very poor and be used as an instrument of the State in this way.

What you want is to disburse purchasing power, not money. You are not talking about money: You have to bear that in mind. You are talking of money as purchasing power. The difference between those two is the same as between goods and consumers' goods. It may be the same pair of pants, but it is not a consumers' pair of pants until some-

body has bought it, and money is not purchasing power until somebody is spending it, and that is incidentally one argument against dropping money out of airplanes or giving it to a very large cross-section of the population as ex-soldiers. Ex-soldiers are rich and poor, merchants, beggarman, etc. But what you want in order that every single cent, a hundred cents on the dollar disbursed shall be purchasing power is to give it to somebody who can be trusted with this very grave responsibility of spending every penny.

If you were to select somebody from the population upon whom you could impose that grave responsibility of spending every penny, whom would you select? A rich man or a poor man? I would not trust a rich man around the corner because I would be scared to death he would go and invest it in something, because that would spoil it all. What you want is a man so poor that you could count on him to spend every single penny. The very poor are made just to order for you. It may be that that will ultimately corrupt them and that they will all go to hell. That is too bad. We should burn a candle for them at the altar of a revived industry.

Question-

In what way do you think this standardization of products can best be done, handled in government entirely or in each country without organization -- and how should that be done on this earth?

Answer-

It seems to me that if you are looking at the problem as a whole, the final accomplishment of a really adequate index of supply, that you are thinking of an effort in which a very great number of private agencies, let us say business generally, would necessarily have to cooperate. Take it just like this. Everyone who has ever been engaged in any industry knows that specifications prevail much more generally within industries and business than the public is aware of. Thus, for example, if you go into a butcher shop and ask for Government graded beef, as a rule the butcher will look very blank, but he knows what Government graded beef is. The only thing is that the beef industry does not carry that information through to the consumer.

Now, then, what we are thinking of is a situation in which some agency or other, governmental or quasi-governmental, should serve as a clearing house for the whole process of specification with which, of course, all businesses would necessarily cooperate and most businesses would be glad to.

Question-

To what extent would monopolistic arrangements interfere with this purchasing power?

Answer-

To a considerable extent, of course, and nothing I have said with respect to these special problems of consumers should be understood as depreciating the importance of other economic and industrial problems. Of course, there are special problems on special points. Each industry represents a whole set of special problems. No two industries are alike and

the problem of the administrative organization of income in society is a problem to itself. Problems of monopoly and exclusive control of various industrial areas is one of the problems. The problem of cut-throat competition is another. They reach into the chief ills from which the industry suffers and to which the public is subject through that industry derived from competitive conditions, conditions in which production is of such a character that streets are covered with blood. The goods that you get are stained with the perspiration of the souls of the competitors. Yes. All those special problems remain and demand special consideration. What I am saying is that along with all those special problems of competition and monopoly, we have a general problem which may properly be called the "consumer" problem, because it is a problem of deficient consumption, and irrespective of the question of what or where or by whom, etc.

Question-

Don't you think the consumer should be protected against materials which are adulterated?

Answer-

Sure, and of course, that is what lies behind the whole idea of grading, and labeling, of the exact specification of all consumers' goods. I say I haven't the slight- objection to any store selling silk loaded with tin, or cotton with clay in it or anything of the kind, as long as they put it on the label. "This silk is guaranteed 60% tin by weight".

Did you ever read the Letters of a Self-made Merchant to his son, by the man who for many years has been editor of the Saturday Evening Post, Lorrimer, published 25 or 30 years ago? Old Gorgon Graham was engaged in the pork packing business. One of his competitors put out a line of lard, beautiful, white creamy looking lard. This old fellow was religious and he met that old fellow Graham at a club and he told him his heart had been touched by the hymn "Where is my wandering boy tonight", and he named this lard "My Wandering Boy". The lard was submitted to a chemist and the chemist reported that he must have wandered through a tallow factory because that lard was 20% tallow.

Gorgon Graham then brought out a line of lard of his own, beautiful, in a new can, some suggestion of the can that his competitor was using. He gave it a fancy label, I have forgotten what it was, but it was taken from another hymn, also, and then in large letters across the can ran a sign, "Guaranteed 20% paraffin". He sent that out with all his salesmen and it just knocked the bottom out of the market for the other fellow's lard.

You don't have to have laws to forbid the sale of a product. All you have to do is label it.

WHAT ARE THE ECONOMIC EFFECTS OF SPENDING AS COMPARED WITH SAVING?

By
Harold G. Moulton
President, The Brookings Institution

The problem that we are confronted with this afternoon is, to my way of thinking, the central problem in all economics because the rate of economic progress depends primarily upon the rate at which we are able to develop capital instruments--I mean physical aids to production. Progress depends primarily upon the rate at which we are able to develop these aids to man in his conquest of nature, and you can measure not only the history of progress by the rapidity by which in the different eras new capital has been developed, but you can measure the comparative advance of different countries by the relative rates at which they have developed capital instruments as an aid to man. And so, as I say, the central problem in all economic analysis depends upon the rapidity with which we are able to develop our capital goods and on this depends largely the rate at which we are able to progress in our standard of living.

Now, under primitive conditions, the problem of capital formation appeared in relatively simple terms. I mean to say that under the most primitive conditions the process of creating new capital merely involved the expenditure of a portion of one's time in the production of capital goods as distinguished from consumer goods. A typical instance would be the fisherman who had a good catch one day then had a little time to spare and contrived a rude net or other instruments with which to improve his facility in catching fish. More particularly, pioneer farming illustrates what I call the process of direct capital formation. Those of you who are familiar, as I am, with the conditions of primitive agriculture in this country know that the greater part of the capital supply of American farmers in the way of improving their buildings, in the way of cleared lands, in the way of ditches and fences, etc., was accomplished through the direct process of applying a portion of the farm's labor to the production of capital goods in seasons of the year when he could not produce consumer goods. Certain periods of the year are free for the farmer to make a direct application of his labor to the process of creating what may be called capital goods. Now that gives you an instance of the process of direct capital formation in very simple terms; all that was necessary was for the individual to work hard for certain portions of the year in direct production of capital goods. Now, however, when society becomes more complex and we live, or the bulk of the population lives in crowded citie in city apartments where we work at some specialized task the entire year, and where the saving process becomes indirect, that is to say, if I am to save anything I obviously can't accomplish much by improving my backyard and equipping it with capital instruments, all I can do is to invest my savings; turn my monthly savings over to the investment markets and hope that by indirect processes that money will be taken and labor will be employed and materials purchased for the creation of additional capital goods. What was a direct process begun upon the will of the individual becomes now a complex social process.

Now under the writings upon capital formation, of course begun a long time ago--and they were related

*NOTE: References in this lecture are to "Distribution of Wealth and Income in Relation to Economic Progress," in 4 booklets. Copies of Vols.1,2,& 3 may be secured free from the Falk Foundation, Pittsburgh Pa.(Pub.in collab. with Brookings Inst.)

in the main to the conditions that prevailed in the period when those writings first began to develop-- and according to the traditional theory, the only road to the greatest possible, most rapid accumulation of capital is the road of individual thriftiness involving two things, (1) hard work; thrift in the sense of application of your own energy as directed to resources in the development of new capital goods, and where that cannot be done, then thrift in the sense of restricting your consumptive desires to the end that you may divert a substantial amount of money which you have received into the investment channels, thereby making the amounts of funds available for those who did wish to build capital equipment, and according to the traditional theory, the greater the volume of monthly savings flowing into investment channels, the greater automatically would be the amount of new capital goods created, and consequently the more thrifty the total population and the greater the aggregate volume of funds flowing to investment markets, the greater would be the amount of new capital developed in the course of the year.

Now, lest there be some misunderstanding of terms, let me make very clear what I mean by the formation of capital, what I mean by real capital. We have to distinguish two things, between the actual, tangible, concrete instrumentality of production, which I call real capital goods, and money savings. From one standpoint a good many people say savings and capital formation are the same things. I shall show that they do not necessarily coincide at all times, and in any event the first step in the process of saving is, under modern conditions, the setting aside of money income and rendering it available for investment. That is what I call the process of individual saving. Then the actual construction of new capital goods is the second stage in the process, and we do not get capital in the social sense until those new capital goods have been developed.

A fundamental question with which the world as a whole is confronted at present is whether the capitalistic system of wealth production has perhaps permanently broken down. Many people are fully convinced that it has; others argue that we are suffering merely from periodic economic indigestion and that in due course prosperity will recur and a new era of progress will be inaugurated.

Those who are most concerned about the existing economic situation are thinking of something more deep-seated and basic than the mere fluctuations of the business cycle. They observe that although we have great powers of production, some of which remain unutilized even during periods of prosperity, large sections of the population continue to have unfulfilled desires and needs. This paradox of want amidst what appears to be potential plenty has suggested that there may be a basic maladjustment which seriously impedes the functioning of the economic system. Under these circumstances, the question naturally arises: Would a different distribution of the national income, with a wider diffusion thereof among the masses of the people, promote a more effective functioning of our productive machinery and thereby create progressively larger aggregate social dividends for the benefit of all classes?

This is the fundamental problem which the Falk Foundation hoped might be clarified through systematic investigation. Accordingly, the Foundation appropriated more than $150,000 to the Brookings Institution of Washington, D. C., to enable its research staff to conduct a thoroughgoing inquiry into this basic problem of economic organization.

In the past most of the views

advanced with reference to the bearing of income distribution on economic progress have been derived from deductive reasoning rather than from inductive investigations of the actual working of the economic system. Today, however, statistical materials are more abundant and more trustworthy than in the past, and it is now possible to arrive at reliable conclusions with respect to certain fundamental aspects of the problem and thus to lay the basis for the development of higher levels of economic productivity and higher standards of living in the future.

Under the general title of "The Distribution of Wealth and Income in Relation to Economic Progress", the study at the Brookings Institution has as its purposes: to lay a solid, factual basis for understanding the problem; to locate as definitely as possible the sources of difficulty in our present methods of distributing wealth; to assess the magnitude of whatever maladjustments are found to exist; and to point out the major lines of adjustment which seem to promise to be most useful in bringing about a more efficient utilization of our productive powers.

The magnitude and complexity of the problem made it advisable to divide the study into manageable segments. The work was accordingly laid out under four major divisions: America's Capacity to Produce, America's Capacity to Consume, The Formation of Capital, and Income and Economic Progress. Each of these divisional studies involves a specific and limited objective, and yet each constitutes an important part of the larger investigation.

Digests of America's Capacity to Produce and of America's Capacity to Consume were prepared shortly after the publication of these books and were widely distributed. The following pages attempt a brief summary of The Formation of Capital.

This summary is not intended to supplant the reading of the book itself. It is, rather, a synopsis for a lay world of busy men and women whose time does not permit the close study of the original text. If the summary fails at any point to give adequate data to substantiate the conclusions stated, the fault is chargeable to the effort to keep the summary within reasonable compass. Additional copies may be obtained without charge by application to the Maurice and Laura Falk Foundation, Farmers Bank Building, Pittsburgh, Pennsylvania.

THE FORMATION OF CAPITAL

In order to show the relation of the analysis presented in the Formation of Capital to the larger investigation of which it is a part, it is necessary to begin with a very brief recapitulation of the conclusions reached in the first two volumes - America's Capacity to Produce and America's Capacity to Consume. No detailed summary is required; all that is necessary for the purpose in hand is to state the primary conclusions relating to the basic problem under consideration.

Summary of the First Two Volumes

In Volume I - America's Capacity to Produce - it was shown: first, that unutilized capacity has long been a characteristic of the American industrial system; second, that at the height of the boom period in the late twenties, when the system was operating at its best, the amount of the slack was approximately 20 percent. In periods of depression this percentage is, of course, very greatly increased, rising as high as 50 percent in the current depression.

In Volume II - America's Capacity to Consume - the conclusions which pertain specifically to the primary issue with which the larger investigation is concerned were as follows: (1) the consumptive desires of the American people are very greatly in excess of the nation's productive capacity; (2) the market demand for

consumption goods was, however, considerably less than our capacity to supply such demands; (3) the proportion of the national income that was set aside as savings was large and increasing. This growth in savings was found to be due to the increase in the number of people in the higher income brackets where the bulk of the savings is made.

At the conclusion of the analysis, attention was called to what at first glance seemed like an inconsistency between a major conclusion reached in America's Capacity to Produce and one reached in America's Capacity to Consume. The study of the productive capacity of the United States over the first three decades of the twentieth century revealed no progressive or cumulative piling up of unutilized capacity. On the other hand, the study of the distribution of the national income indicated that an increasing proportion of the national income was being diverted, particularly in the decade of the twenties, into savings channels. The question was then raised: If it is true that money savings have increased faster than consumptive expenditures, why has not the excess of plant and equipment also tended to increase?

The Task of Volume III
The Formation of Capital

The facts assembled with reference to production, consumption, and savings disclosed an unfortunate economic situation but did not reveal the sources of maladjustment. It was still necessary to determine whether the tendency for savings to increase faster than consumption served in any way to impede the operation of the economic system. In the third division of the study an analysis is made of the process by which money set aside for savings is transformed into new capital equipment, and the bearing of this process upon the functioning of the economic system.

The analysis in the third volume is essentially different in character from that in either of the first two studies. Instead of being a statistical presentation of factual material, it is in the main an analytical discussion of economic processes as they work themselves out in a complex business and financial mechanism. For this reason the task of summarizing the results of this volume is much more difficult than in the case of the former volumes. In fact an adequate summary is impossible because of the close-knit nature of the analysis as a whole. All that can be done is to indicate the major outlines of the study and the primary conclusions reached.

The Traditional Theory of Capital Formation

It has been traditionally assumed, in both economic and business literature, that the way in which income is divided as between spending and savings in no way affects the degree to which our productive resources will be utilized. If more money is saved, the greater, it is contended, will be the construction of capital goods; if more is spent, the greater will be the output of consumption goods. An increase in savings would thus merely shift labor and materials from employment in consumption goods industries to employment in capital goods industries; the total disbursements for wages, interest, etc., would be unaffected. Society would, however, have the benefit of an increasing supply of capital goods.

This traditional analysis, it will be observed, is based on the assumption that consumptive demand and the formation of new productive capital are unrelated - that business men will increase the supply of capital goods even though the demand for consumption goods is declining. Clearly, if this be true, there would always be full employment either in the production of capital goods or consumer goods. But

if it is not true - if the expansion of capital goods depends upon a concurrent expansion in the demand for consumption goods - then serious difficulties might well arise. How has this basic issue been clarified?

Concurrent Expansion of Consumption and New Capital

First, it was indicated, on the basis of general reasoning and observation, that an increase in savings at the expense of consumptive demand would reduce the construction of new capital goods as well as of consumption goods. Since business men are concerned with making profits, and since profits from the use of new capital depend upon the ability to sell the goods manufactured by such productive establishments, it was contended that an expansion of plant and equipment will take place in any large way only when consumptive demand is also expanding and the general business situation as a whole is accordingly propitious. It was concluded from this observation that the formation of capital on an extensive scale requires an increasing flow of funds through consumption and savings channels simultaneously.

Second, historical facts were assembled to shed light on the basic issue thus raised. The available evidence showed conclusively that new capital is constructed on any significant scale only during periods when consumption is also expanding. In periods of declining consumption the construction of new capital also decreases, sharply. Eras of great extravagance in consumption have always been the periods in which the production of new capital also increased most rapidly.

Third, the question was raised: How is it possible to finance simultaneously an increase in the output of both consumption goods and capital goods? It was shown that a concurrent increase in the flow of funds through consumption and investment channels is made possible by the expansive quality of our commercial banking credit mechanism. The commercial banking system in periods of business expansion makes loans to business enterprises engaged in the production of consumptive commodities; and by means of loans on collateral and investments in securities they also provide funds for the construction of new plant and equipment. As the volume of business expands in a period of prosperity the disbursements in the form of wages, interest, and profits increase; and the individuals who receive this income are able, as the months pass, to enlarge their purchases of consumption goods and to increase their savings as well. Thus the flow of funds through trade and investment channels is increased simultaneously.

The Controlling Importance of Consumption

It was found from the study of our industrial history that the growth of new plant and equipment is closely adjusted to and dependent upon an expanding demand for consumption goods. The evidence bearing on this question was of two types. First, it was found that changes in the direction of business activity - from depression to recovery or from prosperity to depression - usually begin with facts affecting the consumptive side of the economic picture. Second, it was discovered that the rate of growth of new plant and equipment in a period of industrial expansion is adjusted to the rate of expansion of consumptive demand rather than to the volume of savings available for investment purposes. The detailed findings under each of these headings merit special consideration.

The widespread view that the capital goods industries are of controlling importance in connection with business recovery was found to be true in one sense only, namely, that we cannot have full business activity so long as the capital goods industries are depressed. It is not true, however, that the process of recovery

must necessarily begin with the capital goods industries. Theoretically, it might begin with either the capital goods industries or the consumer goods industries and spread to the other; but the facts show that the changes have usually begun with factors affecting the consumption side of the economic picture.

Recovery from the great depression of the seventies did not begin with increased construction of capital goods. It resulted rather from large wheat crops in the United States in 1877 and 1879, being marketed at relatively high prices because of short crops in other countries. The recovery of 1897 also was rooted chiefly in agricultural improvement resulting from accidental events. The recovery of 1915 was generated by the demand for war supplies emanating from European governments. For the minor swings in business activity in such a period as 1901-13, the lag, where revealed by indices of production of consumption goods and capital goods, is in every case on the side of capital goods.

Available data on the construction industry do not indicate any close relationship between fluctuations in volume of construction and in business conditions prior to the war, as is contended by some people. However, from the data on contracts awarded, in so far as construction has been a potent factor in post-war business fluctuations (particularly 1920-21), the changes have manifested themselves first in buildings used by consumers.

Evidence offered by various statistical series does not indicate that the depression of 1929 began with changes in the production of either consumption goods or capital goods. The break in October occurred in the security markets, with the effects manifesting themselves first in the demand for consumption goods. The sharp but relatively short-lived depression of 1920-21 clearly began with maladjustments on the consumption side of the economic structure. Some depressions have been precipitated by "tight money" and bank failures, resulting in a quick slowing down of activity in the production of both consumption and capital goods. The case which comes nearest to showing a depression resulting from curtailment in capital creation is that of 1873.

Some writers hold the opinion that recovery usually is generated by the development of a great new industry. Recoveries from the great American depressions of the past were not typically initiated by a growth of new industry during the depression. New inventions are made, and new developments are planned in times of depression, but new industries are apparently not launched on a sufficiently extensive scale to bring about general recovery.

The discovery of primary importance was that the rate of growth of new plant and equipment is adjusted to the expansion of consumptive demand rather than to the volume of savings. In the great prosperity period of the twenties the proportion of the national income that was set aside for purposes of investment expanded rapidly; but there was no proportionate increase in the growth of new plant and equipment. Regardless of the volume of money available for purposes of capital construction, the expansion of new capital was adjusted fairly closely to the rate at which consumptive demand was increasing. Business men evidently gauged the profitableness of new capital chiefly by reference to the markets for the consumer goods which might be turned out by such capital.

Why the Distribution of Income is of Basic Significance

It is precisely because the growth of capital depends upon the expansion of consumption that the distribution of income is a matter of such vital importance. If money savings were always automatically converted

into capital equipment, as has been almost universally believed, it would seem that the more uneven the distribution of income and the greater the percentage of the total that is saved the more rapid would be the growth of capital and the greater would be our economic progress. But if money savings are not utilized in the creation of new plant and equipment unless consumptive demand is expanding, then the whole problem assumes a different aspect.

The investigation shows conclusively that money savings are not, under all circumstances, automatically transformed into actual capital equipment. For example, in the great prosperity period of the twenties the proportion of the national income that was set aside for purposes of investment expanded rapidly, and the aggregate volume of funds rendered available to the capital markets in 1928 and in 1929 was in the neighborhood of 15 billion dollars. The amount of new plant and equipment which was constructed, however, was only a fraction of this amount.

Comparison of Security Flotations with Productive Financing

In analyzing the flotation of securities, we must distinguish between "total" financing, "net new" financing, and "net productive" financing. "Net new" financing represents the difference between total issues and the amount of such issues which was used for refunding previously existing obligations. Since refunding operations do not provide money for the creation of new capital, the amount of such issues should obviously be deducted from the total of security flotations. The data on the following page, compiled by Moody's Investors' Service, reveal the proportion of new financing which went for new capital construction annually from 1922 to 1933.

It will be seen from these figures, which may be taken as a rough approximation of the actual situation, that in the later years of the boom period there was a very great disparity between the amount of real capital formation and the amount of securities that was absorbed by the investment market. Whereas in the recovery years 1922-24 three-fourths of the new security flotations were for productive capital purposes, in the three years 1927-29 well under 50 percent went for capital formation. The percentage, moreover, steadily decreased from 1924 until the end of the boom period. The recurring low percentage in 1933 is a direct reflection of the large government flotations for purposes of deficit financing.

Perhaps the best way of indicating the extent of the disparity between supply and demand in the capital market is to compare the amount of investment money available with the supply of new productive issues. In 1929 the amount of funds seeking investment was in the neighborhood of 15 billion dollars, while the amount of new productive issues, including farm and urban mortgages and net foreign loans, was in round numbers 5 billions. The difference was of the same general magnitude in 1928, but progressively smaller in the years preceding.

The Inflation of Security Values

The results of the wide discrepancy between the amount of funds available for investment and the flotations of securities for the purposes of new capital construction were as follows: First, the superabundant supply of funds available in the investment market encouraged and made possible the rapid growth of such business instrumentalities as the investment trust and the holding company. As the following table shows (Table 2), these flotations aggregated more than 2 billion dollars in 1928 and almost 4 billions in 1929.

The funds thus procured were employed almost entirely in the purchase of corporate securities already

(Table 1)

NET PRODUCTIVE FINANCING, 1922-33

(In millions of dollars)

Year	Net new financing	Net Productive financing	Net productive financing as percentage of net new financing
1922	3,568	2,721	76.3
1923	3,812	2,954	77.5
1924	4,521	3,466	76.2
1925	5,141	3,318	64.5
1926	5,208	3,168	60.8
1927	6,152	3,259	53.0
1928	6,682	2,947	44.1
1929	9,155	3,186	34.7
1930	6,068	3,446	57.2
1931	2,835	2,022	71.3
1932	1,148	702	61.1
1933	711	262	36.8

(Table 2)

Year	Investment trusts	Public utility holding companies
1924	$ 44,400,000	$ 246,300,000
1925	208,500,000	401,900,000
1926	96,600,000	532,900,000
1927	418,700,000	883,500,000
1928	1,026,000,000	1,104,900,000
1929	2,951,000,000	1,039,000,000
1930	401,700,000	647,600,000

outstanding. Instead of adding to productive capital, these financial operations merely served to multiply the number of pieces of paper (shares of stock) constituting claims to existing properties. Ordinarily such a diluting process might be expected to depreciate the value of each piece of paper outstanding; but owing to the fact that the money was used to buy existing securities it served instead to boost their prices.

Even with investment trust and holding company flotations counted, the volume of new flotations, it will be recalled, was still some billions less than the amount of funds seeking investment. Funds not otherwise accounted for were absorbed in bidding up the prices of securities generally. The inflation of security values is shown in Table 3 covering the market value (in millions of dollars) of bonds and of preferred and common stocks combined, listed on the New York Stock Exchange.

The enormous rise in security values generated a rapid growth of monetary income which was in no way the result of productive operations. The income from capital gains is commonly regarded by those who receive it much as any other income; and it is available either for consumptive expenditures or for new investment. A considerable amount of such windfall profits during the recent boom was used to expand purchases of consumption goods and services, particularly of the luxury variety. But there was a strong temptation to put such gains right back into the market in order to make further fortune while the making was easy. It should be borne in mind also that the largest gains were those realized by wealthy operators whose consumptive wants were reasonably well satisfied and who accordingly were likely to return the bulk of such income to investment channels.

Thus the income derived from capital gains served to swell very materially the flow of money into investment channels. As this money was reinvested it served anew to push up security prices and thus to make possible another harvest of money income--to be once again invested in the security market "gusher". The inflation of security prices out of all relationship to underlying economic values was undoubtedly a powerful contributing factor in bringing about the depression which began with the stock market collapse of October, 1929.

THE EXPLANATION OF AN APPARENT CONTRADICTION

It may now be recalled that an apparent inconsistency was revealed between a conclusion reached in Volume II and one reached in Volume I. Money savings were found to increase faster than consumptive expenditures; but plant and equipment showed no corresponding tendency to increase relatively to consumption demand. This apparent anomaly is explained by the analysis made in the third volume.

The answer to the question -- What became of "excess" savings?--is that they were mainly absorbed, dissipated, in bidding up the prices of outstanding securities. Instead of going automatically, as has always heretofore been assumed, into the construction of new plant and equipment, money savings were used increasingly for speculative purposes. The expansion of savings relatively to consumption expenditures thus led to financial maladjustments rather than to the piling up of excess plant capacity.

SUMMARY OF CONCLUSIONS

The analysis of the evidence presented in this volume has led to the following conclusions:

1. The facts show conclusively that new capital is constructed on an extensive scale when consumption is expanding rather than when it is contracting. The bulk of capital is created in periods of general economic

(Table 3)

Date	Bonds	Stocks
January 1, 1925	13,676	27,072
" 1926	14,632	34,489
" 1927	16,014	38,376
" 1928	17,683	49,736
" 1929	17,613	67,478
September 1, 1929	16,047	89,668
July 1, 1932	10,060	15,633
January 1, 1934	12,406	33,095

expansion, when productive resources are being more fully utilized than at other times. The process does not involve an extensive shifting of labor and materials from the consumption goods industries to the formation of capital. Nor do the prices of consumption goods and capital goods tend to move in opposite directions.

2. The evidence indicates that in a period when the output of both consumption goods and capital goods is being increased, there is an expanding flow of funds through both consumption and investment channels. This simultaneous increase is made possible by the expansion qualities of our commercial banking credit system.

3. The available evidence also supports the view that the growth of capital is directly related to the demand for consumption goods. First, changes in the direction of business activity in most cases appear to have begun with factors affecting the consumption side of the economic picture. Second, the growth of new capital is adjusted to the rate of expansion of consumptive demand rather than to the volume of savings available for investment. Between 1923 and 1929, for example, the volume of securities floated for purposes of capital creation remained practically unchanging in amount from year to year, despite the fact that the volume of money available for investment purposes was increasing rapidly. Regardless of the amount of money available for capital formation, the growth of capital goods was adjusted to the rate at which consumptive demand was increasing.

The conclusions reached with reference to the dependence of the growth of capital upon the concurrent expansion of consumptive demand have an important bearing upon the relationship of the distribution of the national income to economic progress. If in consequence of wide variations in the distribution of income the proportion of the national income that is saved expands rapidly, there results a maladjustment which retards rather than promotes the expansion of capital.

The rapid growth of savings as compared with consumption in the decade of the twenties resulted in a supply of investment money quite out of proportion to the volume of securities being floated for purposes of expanding plant and equipment, while at the same time the flow of funds through consumptive channels was inadequate to absorb--at the prices at which goods were offered for sale--the potential output of our existing productive capacity. The excess savings which entered the investment market served to inflate the prices of securities and to produce financial

instability. A larger relative flow of funds through consumptive channels would have led not only to a larger utilization of existing productive capacity, but also to a more rapid growth of plant and equipment.

The phenomenon of an excessive supply of funds in the investment markets had never been anticipated. Not only had it been assumed that all savings would automatically be transformed into capital equipment, but it seemed impossible to conceive of a situation in which savings might become redundant. Such a point of view is natural enough in the light of our historical evolution.

In the early history of this country the volume of funds available for the purposes of capitalistic enterprise was persistently inadequate. Business men often found it difficult to obtain the liquid capital, at any price, with which to expand the size of their business undertakings or to exploit new fields of enterprise. In colonial days, for example, the shortage of funds was a continual source of difficulty and a primary cause of irritation with the mother country, which opposed the issuance of bills of credit by colonial governments. Until well into the nineteenth century the volume of savings rendered available through investment channels for the needs of business enterprisers was negligible in amount. The philosophy which emphasized the fundamental importance of increased savings was a realistic one for that age.

In the period since the Civil War, however, two factors have combined to produce a profound change in this situation. The first has been the growth of a well-to-do middle class, with funds available for investment. The second has been the development of the commercial banking system, making possible an expansion of credit to business enterprise for both fixed and working capital purposes. It is these developments which account for the emergence of the United States as a great financial power. Not only do we now have an abundance of funds with which to finance American enterprise, but we are also able to extend credits to the world at large. In this development we have followed the road which England traveled at an earlier date.

At the present stage in the economic evolution of the United States, the problem of balance between consumption and saving is thus essentially different from what it was in earlier times. Instead of a scarcity of funds for the needs of business enterprise, there tends to be an excessive supply of available investment money, which is productive not of new capital goods but of financial maladjustments. The primary need at this stage in our economic history is a larger flow of funds through consumptive channels rather than more abundant savings.

DISCUSSION

Mr. Wadleigh- Dr. Moulton has given us an extremely interesting talk on what is certainly one of the central problems of economics, and I think, as he says, the central problem. Now the essential fact on which this problem is based, that the effort in our modern society -- the decision to save -- that is to set aside a certain part of one's income for purposes which will yield future income rather than immediate satisfaction -- the decision on the part of an individual to save, is separate and distinct from the decision of the business man to increase his plant capacity. Now, as Dr. Moulton pointed out, the traditional viewpoint of the orthodox economists has been that saving and investment are essentially the same thing, and that traditional viewpoint has undoubtedly held back the development of economic science very seriously. The other viewpoint, the viewpoint put forth by Dr. Moulton, has been also suggested by a number of economists. I believe the first to take it was Joplin, who wrote in 1830.

This received very little attention. More recently, the same point of view, in 1890, was put forth in Sweden by Vicksell, and is growing very rapidly at the present time. Now the theory put forth by Vicksell, however, differs in some rather important points from the analysis that Dr. Moulton has given us, and I think it would be interesting to compare the two.

Now, as soon as we recognize that saving and investment are not necessarily equal, the question immediately arises, when saving and investment are not equal, which one of them is it that is out of step with the other? In other words, would we be able to stabilize employment by trying to make saving more nearly equal to investment or by making investment more nearly equal to saving? Obviously, if we are going to make some practical use of our theory, we must have some answer to that question. Now, I take it that the logical outcome of Dr. Moulton's analysis would be to answer that question by saying that when the two are not equal, it is saving which is primarily out of line, for this reason: The demand for investment goods depends, as Dr. Moulton pointed out, on the demand for consumption goods. Now, if saving is increased, the demand for investment goods is reduced, and, consequently, under our present economic system, there is no self-adjusting tendency in investment which causes it to adapt itself to the change in saving; but rather the reverse -- the tendency moving away from adjustment.

Now, that analysis is, of course, entirely reasonable, and I think that one should not hesitate to regard it as final if it were not for this difficulty: Our economic system is full of paradoxes, it is something like Lewis Carroll's looking glass world. You will remember Alice -- let me first explain my point in this way. In our present economic system things work very opposite from the way one would consider reasonable. If we want to achieve a certain result, say the elimination of depressions, and set about to do it in a way which seems most reasonable, we are likely to find that we produce just the opposite result than we expect. You will remember that when Alice got into the looking glass world, she decided to take a walk out of doors. When she got to the door at the foot of a hill, she saw a path leading up the hill. She began following the path that led up the hill only to find it suddenly shaking itself and leading back to the foot of the hill, and she found herself coming in again at the front door because she was in a looking glass world. And our economic system, I think, is a little bit like that. And for that reason, I would like to put forward, for the purpose of comparison, a brief statement of Vicksell's theory. Now, Dr. Moulton pointed out that in periods when the demand for consumer goods is increasing, the rate of investment also increases. It would seem reasonable to believe that it is the increase in demand for consumer goods that causes increase of demand in investment goods. Now, isn't it possible that since we live in a looking glass world, the chain of causation might be the other way around? Suppose we have an increase in investment, which means more construction of buildings, machinery, plants, railroads, etc. That means more wages paid to those laborers, construction laborers, who work on those construction projects. That means more demand for consumer goods. Consequently, it would appear possible that we might be able to increase demand for consumer goods by increasing investment directly. In other words, the impulse may start at either end and then move from one end to the other end.

Now, according to Vicksell's view

and the views of a good many economists who follow Vicksell, it is impossible to say that one is out of step with the other. But the situation is this: They are unequal because the rate of interest is not such as would cause them to be equal.

Now, with regard to the rate of interest. It has often been pointed out that even with stationary income, I mean stationary flow of money, for the purchase of consumer goods, and perhaps even with slightly declining expenditure on consumption goods, investment may be increased through a reduction of the interest rate.

To illustrate: When the interest rate falls, a person who expects to spend, let us say $60.00 a month on installment payments for a house will be able to buy a more expensive house; or, if he buys a house at a given price, the fall in the rate of interest will enable him to pay less for that house. Consequently, without a change in spending power, you may get more building as a result of the fall in the rate of interest. That is exactly what has happened, in the past two or three years in England and Sweden, and perhaps some other countries, and also what is likely to happen in this country in the next few years.

Another illustration: When the rate of interest falls, say from 6 percent to 4 percent, it becomes possible to electrify a good many railway lines which it was not possible to electrify previously. That also means more spending on investment goods, even though demand for consumer goods has not increased.

Now, from that it would seem that if we could adjust the interest rate in the right way, it would be possible to avoid a collapse, even though the proportion of income devoted to saving increases. In other words, the interest rate is one of the most important inflexible elements in our present system. That is the essential provision of the Vicksell theory. And most monetary theories of the business cycle, or rather most proposals for the elimination or mitigation of the business cycle through monetary methods, are based on the idea that interest rates could be made to move in the appropriate fashion. I think you might say that all worth-while monetary proposals for the elimination or mitigation of the business cycle are based on that idea.

Dr. Moulton - Thank you, Mr. Wadleigh. Two points have been raised thus far. The first is with reference to which one of these two things is out of step. Now, my view is that they are out of step with each other, rather than one of them being out of step alone, but I do not hold, as Mr. Wadleigh seems to think I do, that the difficulty is always with the amount of savings or always with the amount of consumption. I was trying to explain at one stage of my discussion that that problem varies tremendously at different stages of a nation's economic development. In the early history of our country, there was undoubtedly a shortage of money savings, but in the later period of our history, the situation is the other way around. That is one of the difficulties that I find with certain types of theories which attempt to reduce things to a universal law capable of application at all times and under all conditions. I stand for the relativity of the economic thought, and, in line with that, I would say that at one stage of our history we had a shortage of monetary savings,-- in order to make the system work effectively, in other stages we have a superfluity of monetary savings.

The second point relates to the question as to the line of causation. Now we have no disagreement on that. I was stressing two factors. As a matter of fact the first was the simultaneous character, and the second was that the actual rate of new

capital construction seems to be adjusted to the rate at which consumption was expanded, even though that meant the piling up of funds in the investment market.

I have been at some pains to point out, in the volume on which this discussion is based, that both those who argue (as I have heard both argue during the last year or so) that the way out of the depression is by starting with the capital goods industries, and those who argue that the way out is to start on the consumption side, are wrong. Wherever it starts, it is an acting and interacting influence.

What Mr. Wadleigh says is true, that a railroad might say, during a long period of depression, "Since interest rates are low, in spite of the depression now would be a good time to build additional plants and equipment". But there are only two or three individual cases in the history of railroads, where a railroad has seized an opportunity, in a depression, to build new plants and equipment, and so surprising have been such developments they have always been very expensive and commented upon whenever they did occur.

That is not the way out of the depression. Statistics of railroad construction and flotation of bonds alike show that this process begins long after -- some months after -- the time varying in different cycles -- long after improvements have begun in other directions.

This leads me to the question of the interest rate theory, a theory with which I am, of course, quite familiar. The interest rate theory has been discussed by a great many writers in connection with long term investment and in connection with short term investment. In fact, it has been one of the most fundamentally accepted theories of political economy that the only thing we have to do to promote recovery is to lower short term interest rates of commercial banking. That has been held -- taken for granted altogether I should say in the period before the World War, and it has been adhered to until very recently by some of the leading economists of the world. They are certain that the only thing necessary to control the whole movement of the cycles was to lower the interest rate -- just lower that interest rate a little. As soon as money can be gotten cheaper more will be taken, just as if you lower the price of wheat more will be taken, and any other commodity. I would like to point out, however, that between 1873 and 1879 the interest paid by the Bank of England year after year fell as low as 1 percent, and sometimes as low as one-half percent, in the open market, with banks going out of business because they could not find any money borrowers; with no business men, in view of the state of the depression, having the slightest desire to take advantage of additional banking facilities. The same thing took place in the decade of the 90's in England as in the United States. In every cycle, in every period of depression that we ever had, one of the most striking phenomena is the long period during which we have very low interest rates.

Other economists have said that the short time interest rate has no effect, it must operate through the long term investment market. The long term interest rate is therefore what is significant. Now these gentlemen who argue this way have made no more study of the history in regard to the long term interest rates than they had with reference to the short term interest rates. We cannot show by reference to our financial history that long term interest rates are decisive factors in promoting business recovery. The low long term interest rate is only one of many

factors, any business man will tell you, and it is by no means one of the most important. It is important to bear in mind in this connection, also, that in the United States at least at the present juncture, not very much, not a big percentage of the long term investment is done by the medium of bonds with fixed interest rates. Now, take the situation in 1929. Out of nine billion dollars of securities floated that year, more than five billion dollars were in the form of stock bearing no interest whatever. They got their money for nothing. And every business corporation, if it thinks the bond interest rate is too high, under the conditions now prevailing in our markets is in a position to borrow through stocks where it had no commitment, through long term investment. I merely make the challenge that if anybody seriously believes that long term interest rates are the decisive factor, whether the interest rate is four or five or six percent, then he had better review very carefully indeed the history of interest rates in relation to the business cycles of the past five hundred years. If I can find real support for that doctrine in that history, I shall be convinced, in spite of other factors, that it is of weighty influence. Otherwise, on the basis of my analysis thus far of the trends of interest rates, I find no support whatever that interest rates are the decisive factor.

Mr. Wadleigh- Now with reference to Dr. Moulton's earlier comment to the effect that his view is the relativistic view of the relation between savings and investment, now, I don't want to quibble about words, but it would seem to me that his view is less relativistic than the Vicksell viewpoint which I suggested that he should comment upon. Dr. Moulton says that during the earlier stages of our development savings were insufficient. During the more recent stage of our development, savings were excessive. Now, deficient and excessive in relation to what? Presumably in relation to the requirement for capital goods. That would seem to indicate that Dr. Moulton regards the rate of saving as being out of step with the rate of investment, and that, I think, can be contrasted with the Vicksell point of view, according to which there is, I think Vicksell probably would have said, there is at any time a rate of interest which will equilibrate the rate of saving with the rate of investment. The increase in the rate of interest will perhaps stimulate savings. It will certainly choke off investment. A fall in the rate of interest will do the opposite. That, I will say, is the Vicksell point of view. I will make some further comments on that in a few minutes.

Now, I believe it is a fact that in most depressions, or in most business cycles, it is the rate of investment which fluctuates most violently and the rate of saving which remains relatively stable. That is to say, during a depression the rate of saving does not fall nearly so rapidly as the rate of investment. Whether it tends to increase or decrease does not matter, but compared to the rate of investment, I believe the rate of saving is comparatively stationary and, correspondingly, on the upswing. It is the rate of investment which rises rapidly, and the rate of saving which remains relatively stable. So that looking at the facts from that point of view, it would seem natural to suppose that the rate of investment is the ohe out of step. If we are going to continue to have voluntary savings, that is so long as our present economic system remains the same, that would mean adjustment of investment to the rate of saving through changes in the interest rate.

Now, Dr. Moulton is skeptical about the effectiveness of the interest rate in doing that. Well, now, I should have pointed out, that it is, of course, the long term rate of interest that is significant

in that connection, and that is one of the things which economists have become convinced about in the last few years. Of course, we know that short term interest rates can be extremely low, they can be even a small fraction of 1 percent and still not stimulate investment, so long as the bond rate remains high, and so long as people are unable to borrow money even at the low rates of interest for residential construction, and residential construction, by the way, is an extremely important part of capital investment of modern communities.

Now, the experience of the last few years, as I said, of England and Sweden, and now that I have thought a few moments about it, I remember in recent publications of the League of Nations, "World Economic Survey", Vol. 34-35, some statistical material is shown to support that general conclusion, namely, that the long term interest rate does have considerable influence on the amount of building. It is pointed out, also, in that paper that quite a number of factors, such as wages of building laborers and prices of building materials, are significant. Of course, nobody would suggest that the rate of interest on short term is the only controlling factor, and that investment is always correlated with the rate of interest, but rather when the circumstances change in such a way as to cause the rate of investment to change, it is possible that through balancing or offsetting adjustment in the rate of interest, a sharp change in the rate of investment can be avoided. That, I pointed out, is the viewpoint on which most monetary proposals for the elimination of business cycles or the mitigation of business cycles are based. I did not mean to suggest that it is my opinion that that is necessarily so. I was merely putting forward that point of view as something for Dr. Moulton to hit at. In fact I am very skeptical whether we can control the business cycle by changing the long term interest rate. Nobody, I think, would be on very safe ground in either affirming or denying it, and I am very skeptical for this reason that our business cycle is the phenomenon of changes in the rate of replacement of capital goods to an appreciable extent.

At the end of a period of prosperity, the amount of capital goods requiring replacement is relatively small and, consequently, the rate of replacement tends to fall off. People postpone replacing their capital goods. I think that that is one of the most important factors leading to a depression, and that is the conclusion toward which the work of J. M. Clark in the National Bureau of Economic Research in particular, and a good many other writers pointed out. Their work points toward that conclusion. I think it is very questionable whether any fall in the rate of interest which is within the range of practical possibility would be sufficient to counteract that falling off in the rate of replacement promptly. Now, after five years or so of depression, a very large part of our capital equipment is out of date and replacement naturally tends to increase. Now, that replacement, as Dr. Moulton pointed out, does not necessarily come out of any flotation of new bonds. It does not even come out of any flotation of securities. In fact, at the present time, as I understand it, the small revival in investment which has taken place thus far is very largely financed by the accumulated bank deposits, the accrued bank balances of existing corporations, and that small beginning of revival of replacement and of investment. It is not really possible very precisely to draw the line between replacement and investment. That small line between capital goods replaced and investment which is now taking place is very largely out of already accumulated corporate funds. And that is due largely to a revival of confidence, due very largely to the fact that

the rate of consumption is beginning to rise. Now, to that extent, I accept fully Dr. Moulton's correction of the somewhat very simplified view of the interest rate aspect of the problem which I set up for him to knock down.

Dr. Moulton - I am sorry, Mr. Wadleigh, that I misunderstood you at one point, and that we have been talking at cross purposes with reference to this out-of-step business. I thought you said the first time that I was concerned as to whether spending and saving were in step, and my comments were addressed to that, but now it appears that what you really meant was whether the rate of money saving fluctuates as much as the rate of investment, and not between the rate of saving and spending, with which I was concerned. Now, I quite agree that the fluctuation in the volume of savings, great as it is at times, is very much less than the fluctuation in the actual amount of what I call investment and what I call new capital. I think we are close together on that point. I should like to make it clear that I don't oppose lower interest rates as one among many factors which are helpful toward bringing about recovery. I am naturally for it and I think the failure of the long term interest rates to drop more quickly may serve, to some extent, as a retarding influence. I find myself in complete accord with Mr. Wadleigh on that point.

Just one other point in Mr. Wadleigh's discussion of the significance of low interest rates brings him to the most favorable ground. He switched from its influence on new building and equipment, in connection with the capital goods in the sense of industry, railroads and public utilities capital and noted that its influence was likely to be more pronounced in connection with the construction of houses. I think that may well be the case because the considerations affecting the owner of a house are different in character from the consideration affecting a manufacturer who depends on the sale of goods made with that new capital to pay for it. When we build a house, we are not counting on selling goods with the capital invested in the house. I think the element of low cost there would well be of more importance than would be the case in connection with industry, railroad or public utility enterprises.

I would like to ask for information because I am not clear as to the facts. Mr.Wadleigh referred to the housing in England in the past year. Has there been subsidy to aid that process, or has it been left entirely to natural forces?

Mr.Wadleigh- It has not been left entirely to natural forces, but with subsidies. Subsidies have changed, but my understanding is that most of this recent boom in residential construction has been middle class houses and that the amount of subsidized houses has been quite small and relatively constant in relation to this new wave of building -- speculative building -- which has taken place in the last few years.

TAXATION

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Such large subjects as the ones assigned to the speakers in this series must in some way be limited. What has been done in the preceding addresses I do not know but today the choice seems simple. We may give our attention to the specific matters now before the country or instead we may survey the broader issues that are involved.

This second approach is the one that will be followed. It is chosen because there are so many of these broader questions upon which it is important to be clear and because our views on these general matters will determine our conclusions regarding current legislation and procedure. If a modification of the announced tital is desirable, the new wording should be: "The Economics of Taxation". Even with this change there will of necessity be many arbitrary decisions regarding what is to be included and what is to be excluded. Also there may be a reiteration of many ideas that to some of you will seem almost platitudinous

Growing Importance of Taxation

First, it is well to remember that the subject is one of rapidly growing importance. In the United States this is evidenced by the strain on all our governmental units -- federal, state and local. During the last year or two we have become increasingly conscious of this and at present there are a large number of new revenue measures before our various legislative bodies. To each of them there are vigorous protests especially from those who believe the proposed new burdens would affect them seriously and unjustly. Running through their comments, it may be noted that one of the most common assertions is that the proposals under consideration are not "sound economics."

This agitation arises out of two main trends of the last few years. One is the very general increase in public expenditures, many of them traceable to the depression and to the demand on our public treasuries for relief. The other is the decline in many sources of revenue, such as the tax on real estate, a decline also related to the long period of business stagnation.

In the excitement of the current political discussion many of the criticisms reflect party bias and the political ambitions of the critics. This is not altogether unwholesome since one of our most important safeguards against misuse of public funds is the obligation of public officials to render an accounting.

Nevertheless it would be a serious error to believe that the general growth in government outlays is due entirely or even primarily to the policies and practicies of a particular administration. There has been an unusually rapid expansion of government activity in the last few years. But a survey extending over decades shows that the trend is not a new one. Recently there has been a sharp rise but the general tendency has been upward for a long, in fact, for an almost indefinite, period, with only occasional reactions. This is so much the case that we must conceive of our problem as related only in part to recent developments. There may be a reaction in the near future but we may fairly expect that it will be only temporary and that the upward trend of government expenditures and hence of taxation will soon be resumed.

Since the hopes of so many present critics are to the contrary, it is well to note, though only briefly, the reasons for this view. Basically the movement is due to the rapidly growing complexity of modern life. Expressed in broad terms, we may say that our social structure has become so involved that no one of us can function effectively unless his behavior is closely related to and coordinated with that of others. Individualism, even of the qualified type of a hundred years ago, is no longer possible. Cooperative effort, whether public or private, is more and more the usual or necessary procedure. In private activity this is evidenced by the extent to which all social life is now carried on by groups -- religious, social, economic. In the economic field there are, of course, many private enterprises but the partnership and even more the corporate form of organization is usual.

But there are a growing number of economic activities which we are unable or unwilling to entrust to uncontrolled private groups. Either the task is beyond their powers or their resources or for one reason or another we fear that private groups would abuse their power and in some way injure us. In many cases our decisions on this point may have been reached ignorantly or unwisely, but this is beside the point. The trend is so unmistakeable that our calculations must be based upon its acceptance. Even legal theory is being adapted to it. My lawyer friends, at any rate, tell me that the courts no longer find it easy to specify a few lines of economic activity as "affected with a public interest." Instead, the drift seems clearly to be toward the view that all business is "affected with a public interest." This necessitates expressing the court decisions in other terms than the older and apparently easier ones.

For these reasons, or for others, if you prefer them, government activities are increasing extensively and intensively. Some of them are immediately revenue-producing but some are carried on at a deficit. These deficits may be total as with the army and navy or the local police and fire departments, or partial as with the federal post office; and deficits when they occur must be made up from other sources, that is, by direct or indirect taxation.

In concluding this section of the discussion, a word should be said regarding "economic planning." It is essentially not a new idea but is the expression currently applied to an old phenomenon. To the extent that we endeavor to look ahead in our public or in our private economic affairs, we are engaged in "economic planning." The movement may be expected to grow. As it does, more and more planning will be public, which is merely another way of saying that governments are increasing their functions both extensively and intensively and looking ahead more as the years pass.

A word should be added about the growth of public indebtedness. To an important extent and often very unwisely, public expenditures have been financed from the proceeds of bond issues. The carrying charges on this debt are an important fraction of the total to be raised through taxation.

Thus far the picture is disheartening. Taxes must be larger as the years pass. It is time to mention certain offsetting considerations. Probably we shall always think of taxes as a burden. In reply two comments are important. One is that payments for service rendered are not necessarily any more of a burden when the services are rendered by a government than when they come from a private source. If we desire certain things done we should decide as intelligently and

as calmly as we can whether they can be done better or more cheaply by government or privately. The second comment is that the national income has been growing rapidly and with occasional setbacks it will probably continue to grow. Even though taxes increase their size should be considered in relation not merely to the expenditures of the government but in relation to the national income from which the taxes must be collected.

The Nature of the Tax Problem

This calls for more elaboration. The tax problem is that of tapping the national income stream. For the most part there is no other way of getting what our governments need. Notice we have said income, not wealth. Thus in a given year, say 1929, the wealth of the United States was perhaps $360,000,000,000. But this wealth was tangible property - land, buildings, railroads, factories, etc. Speaking precisely, this total of nearly $400,000,000,000 could not be used by our various governments. If in some way the machinery of taxation is so devised that a government acquires title to some of this property, government needs are met only in two main ways. Either the government may retain the property and operate it, thus receiving current income, or the government may sell it to some private party, receiving some of that party's income in payment.

This is important to remember when so many persons, often in high places, talk of the way in which taxation destroys the capital of the country. Instead of looking at the $400,000,000,000 of wealth, our attention should be focused on the size of the annual income which is said to have been over $80,000,000,000 in 1929. This annual flow of goods and services is the source of government revenues. A certain part of it must be diverted each year to public as distinct from private uses. The device for reaching it may be known as a property tax, for example, the tax on real estate, but that merely means that the owner of the real estate surrenders to the tax collector a part of his income, the amount being determined by placing a valuation on his real property and applying to this valuation a tax rate. The tax is merely a device for reaching the important thing, that is, his income.

This leads to the conclusion that the larger the national income the larger the amount available to be spent annually either through public or private channels. The task of government is to find satisfactory ways of tapping the national income stream in order that a part of it may be spent for public purposes as distinct from private. Given a certain annual government outlay, the ease of the task varies directly with the size of the national income.

Emphasis should be placed next on the fact that taxation is not taking away and in some sense destroying a part of the national income. Instead taxation merely diverts a part of this income to public rather than to private use. When I pay five dollars for a hat my money, a part of my income, is received by a hat dealer who directly or indirectly uses it as a medium for acquiring another hat for his stock or takes a part of it for his own expenditures (or those of his clerks or partners or stockholders). I receive the hat and usually do not complain. In the absence of friction (which, of course, may be very serious) five dollars of my income is merely diverted into a channel other than if I had spent it for ice cream sodas or for shoes or for a theater ticket. I do not think of it as lost.

But, curiously enough, it is common to think of tax payments as involving an actual destruction of something. Many speak of taxes, taking say 20 or 25 percent of the national income, as lost. Taxes are

used for two main purposes. First is to meet public payrolls, buy supplies, etc. This is the same as my payment for a hat. No more is lost in the one case than in the other except as it can be demonstrated that the government activity is less efficient or more expensive than private. Even if this be shown, the loss is only partial. The only question to be argued is the one already mentioned. Is the service rendered in return for the tax worth the outlay? Second, tax receipts may be used to meet debt charges. But part or all of my five dollars paid for a hat may be used by the dealer to meet notes at a bank or interest on bonds or dividends on stock. My payment to the hat dealer (or my tax payment) merely passes into the hands of some creditor who then uses (or delays in using) the funds. The loss in each case lies in the charges involved. Diversion of funds through government means some loss through inefficiency and because of the cost of collection and disbursement. The same is true when I make a payment to a private individual or corporation.

This suggests still another comment. It is often contended that when governments meet their expenditures by borrowing, the present generation has avoided a burden of placing it on future generations. This is at best a careless way of expressing what occurs. A government official may today secure from me a given amount, say $1,000. If he calls it a tax and gives me a tax receipt, I may say that I have given up something. Perhaps I refer to it as a "tax burden." If instead he calls it a loan and gives me a government bond, my feelings may be soothed and I shall probably call it an investment. Ordinarily, of course, I prefer the bond. If, however, he gives me my choice of a tax receipt or a bond, and assures me that as a bondholder I may rely on being especially taxed each year in the future an amount sufficient to meet the interest and sinking fund charges on the bond, I shall presumably not care whether I receive a bond or a tax receipt. If I am careful in my thinking I shall prefer the tax receipt since I (or my fellows) must be taxed in the future to cover costs of tax collection and disbursement, if bonds are issued.

The burden of a particular activity, whether expressed in terms of backaches and headaches or in monetary terms, is met at the time the activity is carried on -- not by later generations. This is true of both public and private activities. What is left for the future to wrestle with when the funds are borrowed is a new debtor-creditor relationship. If the borrowing is by government, then the government has become a debtor and must levy taxes on the public. In our highly involved modern life, that task may be a difficult and delicate one. Nevertheless, while the government is a debtor, there is a corresponding creditor or a large group of individuals and corporations who are creditors. There cannot be a debt without the existence of some party to whom the debt is owed. This is not to say the task is simple. Far from it. Under certain circumstances it may even be impossible of solution. Yet it is important not to be discouraged merely because a public debt seems large.

We may summarize by saying:

1. Government expenditures have been increasing over a long period of time and this growth may be expected to continue. This means that taxes will not diminish but will increase as the years pass.

2. Payments for service rendered by government or for meeting debt charges assumed by a government are a burden in the same sense as payments to some private party for service or for his or its debts charges. It may, of course, be true in particular instances that government expenditures may be

unwise or wasteful. Unfortunately there is much waste also in particular private expenditures and with widespread effects upon all of us. Each case should be examined on its merits.

3. Tax payments are not per se a drain on national income and certainly not on national wealth. They are a diversion of a part of the national income stream through public channels. Of course taxes may be so unwisely imposed as to increase or to diminish the size of the national income, or even to result in a reduced efficiency of physical property.

4. Financing through bond issues does not save the present generation from burdens. The burden placed on the future is that the government must collect from the ultimate debtors - the taxpayers - the amounts due the creditors - the bondholders. For every debt there is a credit. To some extent the debtors - the taxpayers - and the creditors - the bondholders - overlap. The extent to which this is true is determined by the nature of the tax system.

Certain Problems - General

The problems raised for special consideration may be grouped under two headings, general and special. The general problems are four in number and the answers to them are partly economic and partly non-economic. The first question to be decided is what functions we think are properly of a public nature and hence better performed by government than privately. There are some of these functions on which there seems to be entire agreement. Organizations for public defence and the administration of justice are by common consent and over a long period of time assigned to government. As the years have passed, there have been added to these more primary duties a large number of others until, as previously suggested, the tendency now is to take the view in legal theory that all business is affected with a public interest. We may expect always to have a debatable field and it seems clear that the functions of government are being increased.

It is not easy to indicate a satisfactory economic basis to guide us in making a decision. In part we shall be influenced by our ideas regarding private initiative and other matters. In part, however, we may perhaps say that government will tend to take over these activities which are so large in scope and so lacking in immediate financial return that only government can handle them. There seems also to be a tendency for government to increase its controls and its actual administration of industries which have become somewhat static as distinct from the newer and more dynamic fields of activity. On this, however, no general rule can be presented.

The second general consideration has to do with the nature of the tax system which is to be employed. Again one must speak cautiously but it seems to be true that the trend is in the direction of a greater use of direct as distinct from indirect taxes. The border-line between the two is not clear but the distinction in principle is well known. A direct tax is one which is not shifted by the immediate taxpayer to other persons or groups. The most common and best illustrations are the income tax and the tax on land. Indirect taxes, on the contrary, are those which are in some way passed on by the taxpayer to other individuals or groups, ordinarily through higher prices. Again, clear-cut illustrations are difficult but the sales tax and duties on imports are the most satisfactory ones to mention.

Perhaps a third general problem should be mentioned. There is a tendency in modern tax systems to distinguish between earned or service income and unearned or property

income than on service income. This is in part due to the belief that the owner of property is not in an immediate and direct sense contributing to the national income and to the consequent belief that a heavy tax on him will not in any way diminish the size of the national income.

A fourth question to be answered is whether we shall use taxation for any other purpose than the raising of revenue. Many people urse that this should not be done, while others believe that taxation is an appropriate device for accomplishing broad social ends. No matter what our convictions may be on this general question, there is no doubt about our practice. Thus, in the United States we have used certain of our internal taxes with the avowed purpose of restricting the consumption of alcoholic liquors and many believe that the tax on oleomargarine has as its chief purpose the discouragement of the use of that article with a view to aiding the agricultural groups who are interested in the production of butter. There may be mentioned also our import duties whose intent insofar as they are protective is to foster certain domestic industries. Also there is the tax on the notes issued by other than national banks, in order to give the national banks a monopoly of note issues.

Specific Problems

If we pass from the more general field to the specific problems that are now facing the people of the United States, we may briefly mention three. One of them is what we may call our enlarging economic base. A good illustration is found in our way of using the income tax. In a more simple society than ours, a local government might perhaps impose per capita taxes or even use the income tax. In such a society, incomes are locally earned and can be readily known by local authorities. Today, however, an individual or corporation with its residence in a given community, for example New York City, may receive an income from all parts of the country. In fact, much of it may even come from abroad. Local tax authorities are quite unable to locate the amount and sources of this income since it is so easy to conceal them. The local government can easily record the ownership of real estate but miscellaneous incomes cannot be traced. This makes the income tax quite unsuitable for municipalities. It can be used and is used by many of our States but we are increasingly conscious that even the States can use it to advantage only if there is cooperation of some sort between State and Federal authorities, perhaps through making the Federal income tax returns available in some way to State tax authorities.

Similar comments may be made about inheritance and estate taxes and miscellaneous taxes on corporations. The effect of these is very noticeable in the growing tendency to increase the sources of revenue upon which the Federal government relies. This is due to (1) the increased duties of the Federal government and (2) local difficulties with revenues.

Local governments must rely to a very large extent on real estate taxes, but with the growth of local government functions these taxes are proving inadequate and in times of depression very inelastic in yield. This has led many to the view that our State governments and the Federal government should collect large revenues by using the sources unavailable to the local communities and then distribute receipts. There is, of course, great difficulty in determining the basis of such distribution but the agitation is certain to continue.

In this connection a passing word

should be said of the frequent statements that some of our States and cities are contributing what they deem to be a disproportionate share of Federal revenues. A part of the criticism is, of course, merely an expression of an irrational localism. Final judgment should not be rendered on the issue without due recognition of the fact that individuals and corporations residing in certain localities, as for example, New York, derive a part of their income from their investments and controls in other parts of the country.

At the present time, one of the questions receiving most attention is the proposal before the Congress of the United States to change our method of taxing corporations and to increase the amount of taxes paid by them. Since no bill has up to this time been formed we cannot well discuss details. It is well to point out, however, that the issue raised is a highly important one. Of course much business is still being carried on by individuals but with the passage of time a larger percentage of the income of the country is received in the first instance by our corporations. Any of you who may not be conscious of this fact will find the study by Berle & Means, "Modern Corporations and Private Property," a most valuable survey.

The issue raised is as follows. If the larger part of the national income were received directly by individuals then taxes on the individuals would perhaps be a sufficiently satisfactory method of securing revenues. Or if corporations paid most of their net earnings to security holders these security holders could be taxed rather than the corporations. But if corporations retain a considerable part of their net earnings in order to increase corporate assets or to build up reserves, an important part of the national income may be rendered unavailable for public use. We may expect, therefore, to have an increasing amount of effort to secure larger renenues from the corporations either by requiring them to pay heavier taxes or by forcing them to distribute their earnings to security holders who can then be taxed. As in all such cases, the questions raised are highly technical and the answers to some of the points raised cannot be hurriedly given.

Concluding Comments

What has been said seems to warrant one or two concluding statements. The first is that there seems to be no reason for alarm in the United States over the considerable growth in public expenditures and hence over the amount that must be taken by government through taxation. Those who can easily draw a clear dividing line between those activities which they deem private and those which they consider purely public have no difficulties. But most of us are denied the comfort of such a clear-cut view and are disposed to find instead no definite dividing line. As already stated, our position will probably be determined by many considerations which are not economic or at least are only partly so. Possibly we can at least agree that the growth in public expenditures should not be so rapid that we shall be unable to adjust our taxes to suit. At the present time, there are some reasons for fearing that recent growth has been so rapid that these adjustments will be difficult. Certainly any changes that we may decide upon should be made with a full realization that taxation is intricate and delicate. Public expenditures are now so large that it would seem the part of wisdom at least to slow down, or perhaps to check definitely some of the changes which are going on, in order that we may find satisfactory ways of bringing about many adjustments which are clearly urgent.

A second comment that seem warranted is that we should not become unduly alarmed over the present size

of public indebtedness. Many are deeply concerned and are issuing warnings. It is well to remember that there was a similar concern, particularly over our Federal debt, just after the World War. Our national income, however, was so large during the Twenties that it was possible to meet the enlarged ordinary expenditures of government and to reduce the public debt quite rapidly, until we encountered the current depression. In fact, many people believe, as I do, that in the twenties we could have reduced the debt much more rapidly than we did and to very great advantage. There is every reason to hope that business is now gradually improving and that the national income will grow in size. With a retardation, or perhaps a temporary check, in the growth of government expenditures, we need not find serious difficulty in managing the debt that we now have and in reducing it with as much rapidity as public opinion will permit. There is, of course, somewhere a point in the size of the debt beyond which the task would prove too difficult.

Finally, a brief comment may be appropriate on the possibility of relieving the tension by raising the price level. It is, of course, true that debtors (including governments) can meet their obligations better when prices are high if turnover is adequate. Unfortunately, however, our knowledge of monetary theory and the difficulties of effective administration are so great that we cannot as yet, if ever, risk this method of securing relief. Basically the important matter is to secure a larger national income. This will do more than any other one thing to simplify the problems of taxation. Manipulation of the monetary unit with a view to raising the price level as a method of relief is a device about which we know so little and which is so apt to get out of control that it should not be employed. The time may conceivably come when our knowledge and ability will be adequate for such an approach. That time has not arrived although we are probably learning. Regularity and justice in the collection of public revenues can best be attained if we abandon the thought of relieving the burden by monetary manipulation.